APPENDIX

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72–1490

FEDERAL POWER COMMISSION, *PETITIONER*

v.

TEXACO INC., *ET AL.*

No. 72–1491

DUDLEY T. DOUGHERTY, *ET AL.*, CO-EXECUTORS, ESTATE OF MRS. JAMES R. DOUGHERTY, *ET AL.*, *PETITIONER*

v.

TEXACO INC., *ET AL.*

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

(18 CFR Parts 154, 157 and 250)

Exemption of Small Producers) From Regulation)	Docket No. R-393

NOTICE OF PROPOSED RULEMAKING

(July 23, 1970)

Notice is hereby given pursuant to 5 U.S.C. 553 and Sections 4, 5, 7 and 16 of the Natural Gas Act that the Commission proposes prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers, as hereinafter defined. This would not include percentage sales made by small producers pursuant to percentage sales contracts. Nor would it include sales to interstate pipeline companies by their affiliates.

As a result of the promulgation of Section 157.40 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.40) in Order No. 308 issued October 29, 1965 (34 FPC 1202) small producers were accorded some relief from the filing requirements in Sections 4 and 7 of the Natural Gas Act for sales in the Permian Basin area. The groundwork for this relief was formulated in Opinion No. 468 (34 FPC 169). Subsequently, the same treatment was extended to sales in Southern Louisiana in Opinion No. 546 (40 FPC 530). Specifically, if a producer receives a small producer certificate pursuant to Section 157.40, it may commence new jurisdictional sales in the Permian and Southern Louisiana areas at rates no higher than the applicable just and reasonable base rates determined in Opinion Nos. 468 and 546, respectively (plus upward Btu adjustment for first and second vintage sales in Southern Louisiana). Such a certificate also eliminates the need for filing

(1)

quality statements with respect to existing sales where otherwise required by those

[2]

opinions, but this is significant only where the gas is below pipeline quality. It also obviates the need for a rate change filing up to the applicable ceiling but this is of little importance since there are few small producers collecting rates below the applicable ceiling who are contractually entitled to higher rates. The relief previously granted has been inadequate for small producers since they still bear many of the expenses and burdens of complying with regulatory requirements, particularly when they seek the same treatment accorded large producers. Such relief has also increased the difficulties inherent in processing small producer filings from an administrative viewpoint instead of decreasing these problems as was intended.

Mr. Justice Clark speaking for the Court in *F.P.C. v. Hunt,* 376 U.S. 515 (1964) recommended that the Commission consider procedures for the exemption of small producers. Our present proposal would relieve small producers in all areas of almost all of the expenses and burdens connected with regulatory matters after exemption is authorized. It should also facilitate more effective regulation of large producers by permitting us to expend our efforts with respect to natural gas production exclusively on such large producers. Small producers account for a relatively small share of the natural gas produced nationally. Moreover, as a practical matter, the small producer is normally not in a position to obtain more for the sale of its gas than the large producer whose jurisdictional sales are subject to the ceilings prescribed by the Commission in each area. The impact on the consumer of exempting small producers from regulation should thus be minimal. The exemption of small producers should also encourage them to increase their exploratory efforts which are important in the discoveries of new sources of gas.

Under our proposal small producers upon application therefor will be exempted by Commission order from all provisions of the Natural Gas Act and the Commission's Regulations otherwise applicable to the jurisdictional sales covered by such exemptions,

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except for the requirement that they submit annually a document setting forth their total volume of jurisdictional sales. The exemption so ordered would continue as long as the small producer's jurisdictional sales do not exceed 10,000,000 Mcf in a calendar year when aggregated with all jurisdictional sales of affiliates as hereinafter defined. Should a producer cease to qualify as a small producer, it would be required to file separate certificate applications and individual rate schedules for future sales but the exemption previously granted would remain in effect for sales made under contracts dated prior to such termination.

If the rules proposed here are adopted, any order granting exemption to a small producer pursuant to such rules would provide for the exemption to be effective 45 days after the issuance of such order. In this connection we propose to allow pipeline purchasers to file rate increases which are limited to tracking rate increases resulting from the exemption of small producers by waiving, where necessary, the requirement for supporting schedules under Section 154.63 of our Regulations (18 CFR 154.63), provided such schedules are submitted within four months from the date of the pipeline's increased rate filing. Producers who have received small producer certificates under the present provisions of Section 157.40 or who have applied and qualify but have not yet received such a certificate would not be required to file new applications unless otherwise directed in any order issued herein.

The exemption for small producers proposed here would include, *inter alia*, jurisdictional sales made by a small producer to a large producer. However, the resale of such gas by the large

producer would remain subject to our jurisdiction. If there are any problems in this regard, large producers in their comments should discuss these problems.

We have not proposed any disposition of increased rates collected subject to refund in Section 4(e) cases or initial rates collected under temporary certificates issued pursuant to Section 7 by small producers for the period prior to the effective date of the exemption. The proceedings to which we refer here are those proceedings where the Commission has not

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yet taken any action and none is now pending as a result of an examiner's decision. Interested parties, however, in their comments are invited to address themselves to the questions of terminating such proceedings and relieving the small producers of any potential refund obligation therein.

Accordingly it is proposed to amend Part 154, Rate Schedules and Tariffs, Part 157, Applications for Certificates of Public Convenience and Necessity and for Orders Permitting and Approving Abandonment under Section 7 of the Natural Gas Act, and Part 250, Forms, in Chapter 1, Title 18 of the Code of Federal Regulations in the manner set forth below.

The Commission also proposes to waive the provisions of Section 154.63 of the Commission's Regulations under the Natural Gas Act solely to the extent necessary to permit the tracking by pipeline purchasers and by pipelines purchasing from such pipeline purchasers of rate increases resulting from the exemption of small producers, *provided* that with respect to such pipelines which are not presently authorized to track supplier increases either through approved settlements or outstanding orders of the Commission the supporting schedules required by Section 154.63 shall be filed within four months from the date of such pipeline increased rate filing; and provided further that the rate or rates as revised by such tracking filings shall be collected subject to reduction and refund from the effective date of such increased rate or rates.

The proposed amendments to Parts 154 and 157 of Subchapter E, Regulations under the Natural Gas Act, and to Part 250 of Subchapter G, Approved Forms, Natural Gas Act, Chapter 1, Title 18 of the Code of Federal Regulations would be issued under the authority granted the Federal Power Commission by the Natural Gas Act, particularly sections 4, 5, 7 and 16 (52 Stat. 822, 823, 824, 825, 830, 56 Stat. 83, 84, 61 Stat. 459, 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o).

[5]

All interested persons may submit to the Federal Power Commission, Washington, D.C. 20426, not later than September 8, 1970, data, views, comments, and suggestions, in writing, concerning the proposed amendments to the regulations and the proposed exemption application and annual statement forms. An original and nine conformed copies should be filed with the Commission. In addition, interested persons wishing to have their comments considered in the clearance of the proposed exemption application and annual statement forms under the provisions of the Federal Reports Act of 1942 may at the same time submit a conformed copy of their comments directly to the Clearance Officer, Office of Statistical Standards, Office of Management and Budget, Washington, D.C. 20503. Submissions to the Commission should indicate the name and address of the person to whom correspondence in regard to the proposal should be addressed, and whether the person filing them requests a conference at the Federal Power Commission to discuss the proposed amendments to the regulations and the proposed forms. The Commission will consider all such written submissions before acting on the matters herein proposed.

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A. The following are proposed amendments to Part 157. Chapter 1, Title 18 of the Code of Federal Regulations.

1. Revise "§ 157.40, Small producer certificates of public convenience and necessity" so that it will read as follows:

§ 157.40 Exemption of small producers

(a) *Definitions.*

(1) A 'Small Producer' is an independent producer of natural gas as defined in § 154.91 of this chapter, who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of 'affiliated producers' are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year. As used in this section, the term 'jurisdictional sales' includes volumes of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this section has an interest in such sales, but does not include sales made pursuant to percentage sales contracts.

(2) 'Affiliated producers' are persons who, directly or indirectly, control, or are controlled by, or are under common control with, the applicant producer. Such control exists if the producer has the power to direct or cause the direction of, or as a matter of actual practice does direct, the management and policies of a person, whether such power is exercised alone or through one or more intermediary companies, or pursuant to an agreement, and whether such power or practice is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, relationship of blood or marriage, or any other direct or indirect means. For the further purposes of this section, the term 'agreement' shall not include any agreement for the

'agreement' shall not include any agreement for the

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operation of a natural gas producing property or a plant processing natural gas unless such agreement otherwise establishes the power to direct or cause the direction of the management and policy of a person.

(3) 'Small producer sales' are (i) sales by a small producer of his own interests under his own contracts; (ii) sales of all interests under a small producer's contract if producers not qualifying as small producers have interests which in the aggregate are no greater than 12-½ percent; and (iii) sales of a small producer's interests under another producer's contract.

(b) *Requirements for exemption.* Upon the approval of appropriate applications made pursuant to the provisions of this section, Small Producers will be granted exemption with respect to their 'small producer sales' of natural gas in interstate commerce.

(1) Small Producers may apply for exemption to cover all previous and all future jurisdictional sales, which do not raise the producer's total jurisdictional sales on a nationwide basis above 10,000,000 Mcf during any calendar year. Applications by these producers shall include the following information: (i) total jurisdictional sales on a nationwide basis for the year preceding the application; (ii) a list of outstanding certificates and rate schedules together with names and percentage of interest of other interest owners under such rate schedules; (iii) a list of outstanding rate schedules of others in which applicant owns an interest together with applicant's percentage of interest; and (iv) the names of all owners (stockholders, partners, joint venturers, etc.) of the applicant with an interest of 10 percent or more,

their percentage of ownership in the applicant and in any other natural gas company, and

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any positions such owners may hold with another natural gas company.

(2) An applicant for exemption who has no outstanding certificate issued by, or rate schedule filed with, this Commission for the sale of natural gas shall include the following information in his application:

(i) a list of all contracts to sell natural gas in interstate commerce,

(ii) source of production, total rate and the annual volume delivery obligations of the producer under each such contract, together with names and percentage of interest of other interest owners under each such contract, and

(iii) a list of owners of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company and any position such owners may hold with another natural gas company.

(3) The application shall contain the information required by the form set out in § 250.10 of this chapter. A conformed copy shall be served upon each of the applicant's purchasers.

(c) *Duration of the exemption.* The exemption authorized hereunder shall remain in effect for small producer sales until the Commission on its own motion or on application terminates such certificate because the producer no longer qualifies as a small producer or fails

to comply with the terms of the exemption. Upon such termination the producer will be required to file separate certificate applications and individual rate schedules for future sales but the exemption will still be effective as to those made under contracts dated prior to such termination.

B. The following are proposed amendments to Part 154, Chapter 1, Title 18 of the Code of Federal Regulations.

1. Revise paragraph (f) of § 154.91, § 154.104 and § 154.110. As revised, these portions of Part 154 will read:

§ 154.91 Applicability.

* * * * *

(f) *Filings by certain non-signatories.* Where the operator and the signatory co-owners in a particular sale have secured exemption pursuant to § 157.40 covering the sale, and where any non-signatory co-owner's interests are not covered by such exemption, such co-owner may file rate schedules, rate changes, or certificate applications with respect to such interests notwithstanding the provisions of paragraph (d) of this section.

* * * * *

§ 154.104 Annual statements by small producers.

Annual statements certifying to the matters enumerated in the form set out in § 250.11 of this chapter shall be filed by all producers, either individually or by groups, who have been exempted under the provisions of Section 157.40. The statements shall be submitted by April 1 of each year for the preceding calendar year.

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§ 154.110 Applicability of §§ 154.92 through 154.102.

Sections 154.92 through 154.102 shall apply only to those persons specified in § 154.91 and shall not apply to small producer sales which are exempted under § 157.40 of this chapter."

C. The following are proposed amendments to Part 250, Forms, Chapter 1, Title 18 of the Code of Federal Regulations.

1. Revise the title of § 250.10 so that it will read:

   § 250.10 Application for small producer exemption.

   Revise the test of § 250.10 by substituting therefor the proposed form entitled "Application for Small Producer Exemption" all as set out in Attachment A hereto.

2. Revise the title of § 250.11 so that it will read:

   § 250.11 Annual statement for independent producers holding small producer exemptions.

   Revise the text of § 250.11 by substituting therefor the proposed form entitled "Annual statement for independent producers holding small producer exemptions" all as set out in Attachment B hereto.

The Secretary shall cause prompt publication of this notice to be made in the Federal Register.

By direction of the Commission.

Gordon M. Grant,
Secretary

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§ [illegible]

APPLICATION FOR SMALL PRODUCER EXEMPTION

(See § 157.40(a)(3))

NOTE: Independent Producers of natural gas whose total jurisdictional sales on a nationwide basis for the preceding calendar year, combined with those of "affiliated producers," were not in excess of 10,000,000 Mcf may file the information called for in this form for a Small Producer Exemption to sell gas (in four copies). Include volume of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this Section 157.40 has an interest in such sales. Do not include sales made pursuant to percentage sales contracts. If insufficient space is given for a complete answer, continue the answer on the reverse side or on a separate sheet, noting the relevant number.

1. NAME OF APPLICANT	2. STATE OF ORGANIZATION
3. LOCATION OF PRINCIPAL PLACE OF BUSINESS	4. TYPE OF ORGANIZATION (Corporation, partnership, joint venture, etc)

5. PERSON RESPONSIBLE FOR APPLICATION

NAME AND TITLE	MAILING ADDRESS

6. TOTAL JURISDICTIONAL SALES VOLUMES OF ______ [illegible] FOR CALENDAR YEAR PRECEDING APPLICATION. (If more than one applicant is to be covered by this exemption, give the total jurisdictional sales volumes of each applicant separately.)

7. LIST ALL CERTIFICATES PRESENTLY HELD BY [illegible] AND LIST ALL [illegible] ON FILE WITH THE COMMISSION AS RATE SCHEDULES BY RATE SCHEDULE [illegible]. INCLUDE IN SUCH LISTING APPLICANTS' INTERESTS IN GAS SALES COVERED BY OTHER PRODUCERS' CERTIFICATES AND RATE SCHEDULES. LIST ALL INTEREST OWNERS AND THE AMOUNT OF THEIR INTEREST FOR EACH SALE TO BE COVERED BY THIS EXEMPTION. (See reverse side for reporting)

8. LIST ALL OWNERS OF MORE THAN 10 PERCENT INTEREST IN APPLICANT: (A) INDIVIDUAL NAME; (B) PERCENT OF OWNERSHIP

9. LIST ALL INTEREST HELD BY THE INDIVIDUALLY LISTED OWNERS IN OTHER NATURAL GAS COMPANIES: (A) INDIVIDUAL NAME, (B) COMPANY NAMES, (C) PERCENT OF APPLICANT OWNERSHIP.

10. LIST FOR EACH OWNER THE POSITIONS HELD BY THESE INDIVIDUAL OWNERS IN APPLICANT COMPANY OR ANY OTHER NATURAL GAS COMPANY.

11. IS APPLICANT OR ANY INDIVIDUAL OWNER LISTED, AFFILIATED WITH ANY PURCHASER OF JURISDICTIONAL GAS FROM APPLICANT? (If so list name of buyer and seller for each sale and nature of affiliation.)

SIGNATURE	TITLE	DATE

FPC Form 316-A
Rev (6-72)

(12)

[12]

SALES UNDER RATE SCHEDULE OF APPLICANT				
APPLICANT	DOCKET NUMBER	RATE SCHEDULE NUMBER	[illegible]	
			NAME	PERCENT INTEREST

APPLICANT'S SALES UNDER RATE SCHEDULE OF OTHERS			
OTHER SELLER	DOCKET NUMBER	RATE SCHEDULE NUMBER	APPLICANT'S PERCENT INTEREST IN RATE SCHEDULE

NOTE: Place an asterisk (*) after each co-owner name whose interest is not to be covered by the Small Producer Exemption applied for.

FPC Form [illegible]
Rev. [illegible]

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Attachment A - Page 1 of 1

§250.11 Annual Statement for Independent Producers holding Small Producers Exemptions.

(See § 157.40 of this chapter)

I hereby certify that total sales subject to the jurisdiction of the Federal Power Commission made by the undersigned and its affiliates for the calendar year 19__ were ________________ Mcf at 14.65 psia. The pertinent information relating to each of these jurisdictional sales is as follows:

Area	Purchaser	Volume	Price

____
(Name of Small Producer)

____
(Signed)

____
(Representative Capacity)

____
(Docket No.)

FPC Form 314-B
(3-71)

[14]

BEFORE THE

FEDERAL POWER COMMISSION

Initial Rates for Future Sales of Natural Gas)	Docket No. R-389A
Exemption of Small Producers from Regulation)	Docket No. R-393
Termination of Moratorium in Southern Louisiana)	Docket No. R-394

RESPONSE OF NEW YORK COMMISSION
AND MOTION TO DISMISS

Just six weeks ago, Judge J. Skelly Wright, speaking for a unanimous panel of the United States Court of Appeals for the District of Columbia Circuit, began his landmark decision in *Moss* v. *C.A.B.*, D. C. Cir. No. 23627 (July 9, 1970), with this stark and incisive statement of the issue:

> "This appeal presents the recurring question which has plagued public regulation of industry: whether the regulatory agency is unduly oriented toward the interests of the industry it is designed to regulate, rather than the public interest it is designed to protect."

Answering this question in the affirmative in *Moss*, the Court found that the CAB, in granting the airline industry rate increases without following the proper hearing requirements, had demonstrated that it was unduly oriented toward the

regulated industry and insensitive to the airline-riding public;* accordingly, the Court invalidated the Board's order granting increases and remanded the case for further proceedings.

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With the ink not yet dry on Judge Wright's decision in *Moss*, the Federal Power Commission, in a series of three notices of proposed rulemaking issued during the latter half of July, has proposed, without statutory authorization, to dismantle regulation of rates charged by producers for the interstate sale of natural gas at the wellhead. The entire program–which hardly reads like the work product of a government agency charged by law to assure consumers "a complete, permanent and effective bond of protection from excessive rates and charges," *Catco*, 360 U.S. 378 at 388–is of highly questionable legality, is patently unwise, and, because of its present deleterious effects, should be abandoned at the earliest possible moment.

It is ten years since the late Dean Landis, in his memorable Report on Regulatory Agencies to the President-Elect, witheringly observed:

> "The Federal Power Commission without question represents the outstanding example in the federal government of the breakdown of the administrative process . . .
>
> "These defects stem from attitudes, plainly evident on the record, of the unwillingness of the Commission to assume its responsibilities under the

* After all, there is more to rate-making than providing carriers with sufficient revenue to meet their obligations to their creditors and to their stockholders." *Moss*, slip op. p. 20.

Natural Gas Act and its attitude, substantially contemptuous, of refusing in substance to obey the mandates of the Supreme Court of the United States and other federal courts.

* * *

"... The Commission's past inaction and past disregard of the consumer interest has led the states to seek to force it to discharge its responsibilities. It is somewhat of a phenomenon in our national life for the state utility commissions to be ranged against a federal commission in an effort to protect consumers against monopolistic and excessive rates ..." Landis Report, 54-56.

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The current regulatory picture–as revealed by the three rulemaking notices–is in many respects more distressing than it was at the time of the Landis Report. Whereas in 1960 the Commission could be criticized for its failure to fix just and reasonable wellhead prices, today the criticism is that, having finally determined just and reasonable area rates and having been sustained on appeal, the Commission now proposes to abandon the rates thus determined and escalate sharply the prices to be charged the consumer. And the Commission's sole basis for this proposed abandonment of its regulatory responsibility is the current gas supply situation as it relates to the interstate market. Yet the Commission has failed to act on the New York Commission's request, filed over eighteen months ago, for an investigation into the adequacy of natural gas reserves (Docket No. R169-470) and, without either investigating the causes of the supply situation or inviting the Justice Department to do so, has simply assumed that the shortage has been caused by the prices fixed by the Commission in its September 1968 opinion in the Southern Louisiana Area Rate Proceeding.

If, however, the shortage has not been caused by the price set in Opinion No. 546, then it necessarily follows that the shortage cannot and should not be solved by elevating those prices. As the Honorable George P. Shultz–surely the highest-ranking economist in the administration–has recently testified,* the petroleum industry

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> "is capable of behaving irrationally for short periods, and even of contriving an apparent disaster by ceasing exploration [and] dramatically revising its reserve additions downward ... [Such industry action could] produce an appearance of crisis calling for immediate 'corrective' action, e.g., ... higher prices ..."

Secretary Shultz expressly warned of the difficulty of distinguishing between "a fake disaster and a real one" since "the 'facts' for decision will be produced largely by these same firms and associations."

Until the Commission has satisfied itself on the basis of testimony that has been subjected to cross-examination that (1) the present gas shortage has been caused by unduly low interstate price ceilings, (2) that the shortage will be eliminated or at least substantially alleviated by higher ceilings, and (3) that the cost placed on the consumer of the higher ceilings is not disproportionate to the volume of new supplies, the Commission should not, and cannot lawfully, tamper with its present ceilings.

In the fifteen years following the Supreme Court's *Phillips* decision, when consumers were seeking relief from excessive

* Testimony before Senate Judiciary Subcommittee on Antitrust and Monopoly, March 3, 1970.

producer prices, no reductions in any producer prices was made until after the producer had been granted a full hearing, the examiner had issued a decision, the case had been argued to the Commission, and the Commission had fully deliberated and entered an opinion. And even then, stays of the reductions were granted pending judicial review. (And, in the case of the important Southern Louisiana area, reductions continue to be stayed even after judicial affirmance.) In contrast, when the industry demands an increase in the ceilings, the Commission proposes that it be granted *instanter*–without hearing,

without proof, without possibility of refund. This disparate treatment of consumer and industry claims can hardly be expected to inspire confidence in the administrative process.

We turn now to certain of the more glaring defects in the three rulemaking dockets.

R-389A: Increased Initial Rates

1. The Commission's intention to permit, via rulemaking, higher new gas rates that "will be firm rates, not subject to refund" violates the Commission's statutory obligation to protect the consumer from excessive rates, as explicated in considerable detail by the Supreme Court in *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378 (1959).

2. We believe that any determination to allow a higher rate of return in the computation of unit costs than that allowed in Opinion No. 546 should rest upon an evidentiary record.

3. We believe that the Federal Power Commission can give no significant weight to market price or commodity value

concepts. The basic function of regulation is to establish a price other than what would obtain in the absence of regulation, but "market price" merely defines what the unregulated price would be.

R-393: Small Producer Exemption

1. No rational basis has been shown to justify exemption of small producers. The procedures for small producers established in *Permian* and *Southern Louisiana* reduce the regulatory burden on those producers

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to a minimum so long as they receive no more than the area rate ceilings. There is no visible support for the claim that "the relief previously granted has been inadequate for small producers." Nor is there visible support for the implication that present regulation of small producers has absorbed any significant time of the FPC staff so that "more effective regulation of large producers would result" if small producers were exempted.

2. The Commission's contention that "the small producer is normally not in a position to obtain more for the sale of its gas than the large producer" has little present relevance, for in fact these are not normal times. As the Commission well knows, necessitous buyers have been willing to pay 10¢ or more above the FPC ceilings to meet shortages, see, e.g., emergency purchases by Natural Gas Pipeline Co. purportedly pursuant to Order No. 402. An increase of 10¢ per Mcf on the 15% of the gas sold by small producers would equal an additional $180,000,000 to be borne by gas consumers.

3. It is difficult to square the Commission's present willingness to create a regulatory gap over 15% of the gas sold interstate with its vigorous refusal to allow a regulatory gap over the 4% of the gas used for compressor fuel, *California* v. *Lo Vaca*

Gathering Co., 379 U.S. 366 (1965).

4. The proposed rule opens the way for the major producers to sell their gas in interstate commerce free from FPC regulation by selling their reserves in place to small (or non-) producers, who would in turn resell the reserves under a conventional sales contract to an interstate pipeline.

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R-394: Termination of Moratorium

The Commission's notice sets forth no rational basis for lifting the moratorium provisions of Opinion No. 546. The entire thesis of the two-price system in area ratemaking was that the incentive function was to be provided by the new gas price. Raising the price of flowing gas will merely enrich the oil industry and provide it with additional funds to build refineries or tankers or explore in the North Sea. The Commission's assertions that there are "indications of cost increases" which have affected exploration can refer only to increases in the costs of new gas; there are no indications that the costs of flowing gas, determined by Opinion No. 546, have risen above the rates fixed by that opinion. (It should be noted that the rates in Opinion No. 546 were fixed in excess of costs to take into account future cost increases.) If, and it is a highly unlikely if, the costs of flowing gas exceed the area ceilings, the producers have a present forum, in AR69-1, to so demonstrate. Abolition of the moratorium provisions would not generate additional supplies, but would merely burden the consumer with higher prices.

In view of the foregoing, the Public Service Commission of the State of New York respectfully requests that the Commission dismiss the rulemaking dockets at R-389A, R-393, and R-394. In view of the importance of the questions raised by this

motion, we respectfully request that it be set for oral argument.

Respectfully submitted,

PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK

By /s/ Kent H. Brown
Kent H. Brown, Counsel
44 Holland Avenue

Morton L. Simons
1819 H Street, N.W.

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small	)	
Producers from	)	Docket No. R-393
Regulation	)	

COMMENTS OF
PHILLIPS PETROLEUM COMPANY

Pursuant to Notice in this proceeding issued July 23, 1970, Phillips Petroleum Company (Phillips) submits herewith its comments upon and objections to the proposed rule-making. Correspondence in regard to this proposal should be addressed to the following:

Kenneth Heady
Legal Department
Phillips Petroleum Company
Bartlesville, Oklahoma 74004

Sam Jennings
Manager, Laws and Regulations Division
Gas and Gas Liquids Department
Phillips Petroleum Company
Bartlesville, Oklahoma 74004

Because of the objections raised herein, Phillips requests that a conference be held to discuss the proposed amendments to the regulations and that the persons above named be notified of the time and place of such conference.

[50]

Phillips expresses no objection to the desires of the Commission to relieve small producers "of the expenses and burdens connected with regulatory matters", except to note that such expenses and burdens constitute an equal deterrent to large producers to the commitment of their gas in interstate

commerce. To the extent that the proposed rule-making contemplates higher prices for small producers than large producers, however, Phillips believes that the proposed regulations are both unwise and unlawful. If the Commission seeks amendments to its regulations which will foster an increase in exploratory efforts for natural gas and an increase in commitments of the results of such efforts to interstate commerce, the Commission's action is misguided and misdirected. The ills of a nationwide gas shortage may not be cured by attempts to hide the symptoms. Efforts of interstate purchasers to obtain new commitments of natural gas reserves will not be aided by the proposed regulations. On the contrary, the proposed regulations will constitute the greatest incentive to intrastate sales by large producers since Opinion 468.

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1. Receipt by Small Producers of Above-ceiling Prices Demonstrates That Ceiling Prices to Large Producers Are Too Low.

Exemption of small producers from price ceilings applicable to large producers presents an inexplicable paradox. On the one hand, the Commission recognizes that, "... as a practical matter, the small producer is normally not in a position to obtain more for the sale of its gas than the large producer whose jurisdictional sales are subject to the ceilings prescribed by the Commission in each area." On the other hand, the Commission expects that, "The exemption of small producers should also encourage them to increase their exploratory efforts which are important in the discoveries of new sources of gas." Either the small producer will in fact receive such above-ceiling prices, then the exemption amounts to no more than relief from "the expenses and burdens of complying with regulatory requirements", and the effects upon exploration may be expected to be minimal. On the other hand, if the small producer does receive above-ceiling prices, the willingness of pipeline purchasers to pay such above-ceiling prices rests upon factors totally unrelated to the circumstance that the sale is by a small producer.

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Underlying the philosophy that the Commission may permit small producers to receive above-ceiling prices is the wholly fallacious concept that large producers may, directly or indirectly, be forced to sell their gas in interstate commerce at an artifically restricted price. There is no logical reason why an interstate purchaser would willingly pay a small producer more for a small quantity of gas than it would pay a large producer for a substantial quantity of identical quality gas. Payment of such above-ceiling prices to small producers would simply constitute irrefutable proof that the regulated ceiling price was too low to induce a commitment of gas into interstate commerce. It is wholly illogical to assume that a large producer would be inspired and induced to carry on an expensive exploratory program and commit his resulting discoveries of gas into interstate commerce at prices which are unacceptable to and refused by small producers.

If in fact small producers should regularly be offered and receive above-ceiling prices, large producers would have no alternative except to seek to protect themselves from the innumerable problems arising from such price differentials. Under the trend of recent court decisions, payments of above-ceiling prices to small producers might well establish market values for royalty purposes applicable to large producers. Cf. *J.M. Huber Corporation* v. *Denman*, 367 F.2d 104;

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Texas Oil & Gas Corporation v. *Vela*, 429 SW 2d 866. In this respect, this Commission's decision in Opinion No. 562, *Denman, et al.* v. *J. M. Huber Corporation, et al.*, ____FPC____, is likely to create rather than resolve confusion. It certainly is not inconceivable that knowledgeable royalty owners would refuse to grant oil and gas leases to large producers, preferring to reap the advantages of unrestricted sales by small producers. State tax collectors may likewise decide that values for tax purposes are fixed by sales by small producers rather than regulated ceiling prices applicable to large producers.

These circumstances, alone or in combination, would virtually drive large producers to seek unregulated markets for

their gas in order to maintain parity with small producers. The Commission recognizes in its Notice that "small producers account for a relatively small share of the natural gas produced nationally", yet by this proposed regulation the Commission seems determined to limit the supplies of gas available for the interstate market to that small share produced by small producers.

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Contentions will be made that these dire predictions will not come to pass. But the issue is not whether they will or will not. The issue is whether exemption of small producers will serve any useful purpose. If in fact small producers achieve substantially higher prices than large producers, then the predictions herein made are a distinct possibility. If in fact small producers do not realize any appreciable benefits from exemption from regulation, then these regulations will have served no useful purpose.

Objectives sought by exemption of small producers are laudable, but we believe the Commission is misdirecting its efforts. Substantial increases in exploration, which is the ultimate end sought, can be realized only by higher ceiling prices applicable to all producers, not just to exempted small producers.

2. The Proposed Regulations Unlawfully Discriminate Against Phillips.

The proposed regulations are patently and unlawfully discriminatory as to Phillips and other large producers who

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are engaged in the purchase of natural gas for processing and resale. Page 3 of the Notice states:

> "The exemption for small producers proposed here would include, *inter alia*, jurisdictional sales made by a small producer to a large producer. However, the resale of such gas by the large producer would remain subject to our jurisdiction. If there are any problems in this regard, large producers in their comments should discuss these problems."

Problems abound for large producers in this proposal. Phillips has long been engaged in the business of purchasing and processing natural gas for the extraction of natural gas liquids and resale of the remaining residue gas. Extraction of natural gas liquids is a business separate and apart from the sale of natural gas. *Phillips Petroleum Company*, Opinion No. 338, 24 FPC 537, 562. If this proposed regulation were to become operative, Phillips either would not be able to purchase gas from small producers at all or would be forced to purchase gas at prices more than it could permissibly receive for the resale of such gas. In either event, the proposal seems designed to drive Phillips from the business of extracting natural gas liquids from purchased gas.

In fact, the Commission here seems to be executing the veiled threat first made in the *Permian Basin Decision*, Opinion No. 468. The Commission there stated:

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> "Hunt urges that residue gas must be priced higher than gas-well gas so that a processor selling residue gas can cover his processing costs plus a return on his investment in addition to the price of the gas-well gas he purchases. This reasoning ignores the fact that salable liquid hydrocarbons are derived from the gas that is processed. The principal purpose of such processing is the removal of these liquids so that revenue may be realized from them. There is every reason to believe that the value of the liquids will be sufficient to justify gasoline plant processing of new gas-well gas. If not, there is no apparent economic reason to encourage the processing at gasoline plants." (34 FPC at 211)

The proposed regulations make sheer mockery of the statement, "There is every reason to believe that the value of the liquids will be sufficient to justify gasoline plant processing of new gas-well gas." Under the proposed regulations there is nothing to prevent a pipeline purchaser from paying the small producer an above-ceiling price plus the value of all of the

liquids contained. There is simply no way under such conditions that the producer-plant operator could remain in businesss.

These harsh results are by no means mollified by the statement in the first paragraph of the Notice that the proposed regulations "would not include percentage sales made by

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small producers pursuant to percentage sales contracts." This provision would mean simply that producer-plant operators such as Phillips could purchase gas from small producers under percentage contracts only where no interstate pipeline was willing or able to make such purchase. No rational small producer would choose to sell his gas to Phillips at a percentage of the ceiling price if the gas could be sold to an interstate pipeline at prices well above the ceiling plus liquid values.

Contrast this treatment of large producers with the provisions of page 4 of the Notice applicable to interstate pipelines:

> "The Commission also proposes to waive the provisions of Section 154.63 of the Commission's regulations under the Natural Gas Act solely to the extent necessary to permit the tracking by pipeline purchasers and by pipelines purchasing from such pipeline purchasers of rate increases resulting from the exemption of small producers***"

Discrimination could not be more clearly stated. Pipelines purchasing from small producers are to be held harmless from the increased costs resulting from such purchases. Even those pipelines purchasing from the original

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pipeline purchaser are afforded protection. The large independent producer, on the other hand, is specifically prohibited from increasing its resale rates to take into account higher prices paid to small producers.

Justification for such discrimination does not exist. There is no rational basis for preventing producer-plant operators from increasing their rates to account for above-ceiling rates paid to exempted small producers. Nor is there rational basis for

requiring large producers to bear any portion of this additional expense out of nonjurisdictional liquid revenues. Problems of rate determination for large producers are no more complicated than those for pipelines which are expressly permitted to take such above-ceiling rates into account in fixing their resale rates.

Experience in rate adjustments of this type has already been gained under the regulatory policies imposed by Opinion No. 468. That decision expressly provides that "The ceiling price for new gas-well gas will be applicable to residue gas which is derived from new gas-well gas." (34 FPC at 211) Consequently, new gas-well gas purchased by Phillips from another producer retains its character even though resold by Phillips under a contract applicable to flowing gas. Phillips has filed and the Commission has accepted rate schedules which,

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although generally applicable to flowing gas, specify the higher ceiling rate for that portion of the gas delivered which is purchased from other producers under contracts qualifying such gas as new gas-well gas.

No reason exists or has been suggested why similar modifications could not be made in Phillips' rate schedules to account for above-ceiling rates paid to exempted small producers. For lack of such reason, the proposed regulations must be classed as arbitrary and capricious as well as discriminatory.

Aside from such effects upon Phillips and other large producer-processors of natural gas, the consumer is by no means served by this proposed discrimination against large producers. A very substantial portion of Phillips' present supplies of gas purchased and resold in interstate commerce is represented by purchases of gas from small producers who would be exempted. Generally these contracts are of relatively short duration or have been in effect for a sufficient length of time that these contracts will expire by their own terms in the relatively near future. By virtue of their exemption, these small producers could terminate deliveries to Phillips at the expiration of their contracts.

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For the consumer, such terminations would mean either added costs for both gas and facilities or loss of such gas supplies to intrastate markets. At the end of the contract term, the small producer would have the option to contract directly with the previous interstate purchaser from Phillips or with another interstate purchaser. In the event a new contract is made with an interstate purchaser, new facilities must be constructed by the purchaser to handle such gas. The consumer must pay not only the cost of the above-ceiling prices to the small producer but the cost of the new facilities as well. In the meantime, Phillips' existing facilities are idle or only partially utilized.

Should Phillips seek to maintain its gas supplies by entering into a new contract with the small producer at the same above-ceiling prices offered by the interstate purchaser, Phillips must divert such gas from the interstate to the intrastate market, since obviously, Phillips cannot purchase the gas at above-ceiling prices and resell it at ceiling prices. Phillips' diversion of such gas to the intrastate market would not constitute an unauthorized

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abandonment, since the abandonment, if technically such occurs, would be by the exempted small producer and no permission would be required. In any event, it would be clearly confiscatory to seek to require Phillips to continue to purchase the gas at a price higher than it was allowed to receive upon resale.

These considerations demonstrate the fallacy of the theories adopted in Opinion No. 468 that "abandonment" is an adequate substitute for above-ceiling prices in hardship cases. In *Permian*, the Commission asserted, "Even in situations where producers are able to show that they are entitled to relief from the obligation to continue to sell flowing gas at the appropriate area ceiling, in most cases it may be sufficient to permit them to abandon their unprofitable sales." (34 FPC at 226) The Supreme Court was persuaded to accept this platitude and even

to accept abandonment as the primary relief in such circumstances:

> "Indeed, the Commission has already acknowledged that only in 'exceptional situations' would the abandonment of unprofitable activities prove detrimental to consumers, and thus impermissible under § 7 (b)." (*Permian Basin Area Rate Cases*, 390 US 747, 773)

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In the light of the present needs of interstate pipeline companies to maintain all of their existing supplies, forced abandonment in lieu of above-ceiling prices to large producers can hardly be classed as service to the consumer.

3. Statutory Authority For Total Exemption Is At Least Doubtful.

Whether statutory authority exists for total exemption of small producers is a matter semmingly not considered by the Commission. The Commission is authorized to classify natural gas companies by size and to differentiate the degree of regulation among such classes. Authority to classify, however, does not inherently include authority to exempt. While the existence or lack of such authority might ordinarily be a matter of more concern to small producers than to large producers, in view of the discrimination against Phillips referred to above in the proposed regulations Phillips must and does hereby challenge the proposed regulations as exceeding the statutory authority of the Commission. We find no warrant in the Natural Gas Act or in the decisions construing the Act for such exemption.

Conclusion

As an effort to induce increased exploration for natural gas, exemption of small producers misses the mark.

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Solutions for gas supply problems are to be found in adequate prices applicable to all producers, not to small producers alone. It is folly to believe that allowing above-ceiling prices to small producers will thereby enable the Commission to induce or even force substantial sales by large producers at unrealistically low prices.

To reach the ends sought, the proposed regulations are unwise. In the manner in which they would be enforced, the proposed regulations are unlawful.

Respectfully submitted,

PHILLIPS PETROLEUM COMPANY

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By /s/ John L. Williford

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August 25, 1970

Federal Power Commission
Washington, D. C. 20426

RE: NOTICE OF PROPOSED RULEMAKING EXEMPTION OF SMALL PRODUCERS DOCKET NO. 393

Gentlemen:

Pursuant to the Notice of Proposed Rulemaking, Docket No. R-393, entitled, "Exemption of Small Producers from Regulation" and your request for comments from all interested persons, I submit for your consideration the following views, comments and suggestions.

First, with reference to my own qualifications, this is to advise that I have practiced law in South Texas for approximately 34 years, during which time I have represented a substantial number of independent oil and gas producers and some majors and have been intimately familiar with the oil and gas industry. I am firmly convinced that the exemption of small producers from regulation under the Natural Gas Act will result in the discovery, production and dedication to interstate commerce of substantially more gas, will increase the quantity of gas available to the consumer and will have very little effect on the ultimate consumer price.

The Commission's Notice proposing an exemption of small producers from regulation under the Natural Gas Act, seems to

be based largely upon the *de minimis* aspects of the small producer in terms of the total volume of gas produced and sold annually by the gas industry. While this fact lends support to the relief of the small producer from price regulation since the dollar impact on the consumer in any event will be relatively small, I do not believe that this position presents the real importance of the small producer to both the gas industry and the consumer.

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Historically the small producer has been the pioneer or wildcatter. He has been the one who has been willing to risk his own capital to venture into new potential gas supply areas and to bear the risk and expense of finding new gas reserves. Additionally, the small producer has been in effect, the catalyst for assembling large segments of capital into joint ventures for exploration and development of gas reserves.

The small producer, with limited capital, and the necessity for a prompt return for himself and to satisfy his associates and investors, has had to be aggressive in the drilling of exploratory wells and in the development of discovered reserves. The large producer, on the other hand, has had almost unlimited capital and through the years, adopted a policy of purchasing large leaseholdings in likely areas or trend plays, holding the leases and paying delay rentals thereon, in many instances waiting for development in the area. If the exploratory efforts of the small producer proved fruitful, the large producer, who usually had holdings in the area, then moved in with its greater capital resources, and developed the newly discovered gas field, and in many instances, purchased the interest of the small producers, adding them to its already substantial reserves. But, the small producer has been the one who in so many instances has been responsible for the discovery of many substantial reserves presently owned by the large producers and committed to interstate commerce. Thus, although the small producer may be *de*

minimis in terms of the total amount of gas produced and sold annually, the great importance of the small producer lies in his gas finding function. The small amount of gas sold by the small producer in interstate commerce does not present a fair, nor an accurate picture as to the real importance of the small producer from the standpoint of discovery of gas reserves.

The advent of Commission producer regulation added a tremendous additional burden to the small producer, both in expense of compliance and legal expenses and in paper work. Because of the small producer's limited operations, the percentage of increase in cost to the small producer has been proportionately greater than to the large producer. Additionally, steadily rising costs of exploration and development, plus the reduction in the depletion allowance,

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have all tended to reduce the incentive of the small producer and his ability to attract capital to conduct exploratory operations. Many of the small producers have been forced to substantially curtail their exploratory operation and some have withdrawn from the oil and gas business entirely, all of which has caused a substantial loss in the exploration for and discovery of new reserves. Relief from the burdens imposed by Commission regulation should attract more capital to the oil and gas business and will induce more small producers to further their gas exploratory operations.

At a time of critical gas shortage, increased gas exploratory efforts are particularly important and, therefore, I believe should receive primary emphasis. Not only is the consumer not economically harmed by the exemption of the small producer from Commission regulation, but more importantly, the consumer will be benefited as a result of the increased gas exploration by the small producer.

The attempt by the Commission to regulate the small producer has proven to be an almost impossible task and has created confusion, chaos and inefficiency in the Commission's oepration. The exemption of the small producer would benefit the Commission in that the Commission's staff could devote its time to the relatively few large producers who are responsible for the production and sale of the major portion of the gas in interstate commerce. Thus, as a result of this exemption, the Commission would be in a much better position to more efficiently and properly perform its primary function of consumer protection.

The rising costs and the diminishing profits of the small producer, resulting in a large measure from Commission regulation, has caused a continuing decline in investment funds for gas exploration. As a result, the exploratory operations of the independent producer have of necessity been substantially curtailed. The exemption of the independent or small producer from Commission regulation would increase the flow of investment funds, would stimulate exploratory operations and result in the greater discovery of gas reserves.

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Because of the tremendous expense of compliance with Commission Regulations, the uncertainty as to the price which the producer will ultimately receive for his gas, plus the possibility of refund obligations, have caused the small producer not to dedicate its gas to interstate commerce, but on the contrary, to sell the gas in intrastate commerce. Attached hereto as Exhibit "A" is a statement of the experience of one group of small producers who sold their gas in interstate commerce and have regretted it ever since. This case illustrates why small producers who have had such experiences would probably never again dedicate gas to interstate commerce and bear the expense of Commission regulation and assume the risk of the ultimate price reduction and refund obligations. If, on the other hand, the

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small producer is exempted from Commission regulation, then the small producer would increase its exploratory efforts and dedicate more gas for interstate consumption.

The Commission suggests, in the Notice, that interested parties are invited to address themselves to the question of terminating present proceedings and relieving the small producers of any potential refund obligation therein.

Everything which has been said above about the importance of exempting the small producer from Commission regulation applies equally to the termination of present proceedings against the small producer and the release to the small producer of monies which he has earmarked for refund. Moreover, if the dollar impact upon the consumer is *de minimis* as a result of the small producer exemption for the future, then logically it would seem to be equally *de minimis* for amounts collected, subject to refund for the past. Due to the numerous imperfections in the refund procedure, there is no real assurance that the refunds, if ultimately required, will be "flowed through" to the ultimate consumer. Therefore, if the refunds are insisted upon, they will simply be a windfall to the distributors, to which the distributors are not really entitled. Because of the small amount of gas sold by the small producers in interstate commerce, even if the refunds of the small producers were flowed through to the ultimate consumer, it would not amount to over a few cents and would be of no real consequence. If these refund proceedings were terminated and the obligation of the small producers to make refunds were cancelled, it would make practically no effect on the price of gas to the ultimate consumer, but would result in placing the small producer in a position to use such monies for further exploration and discovery of additional reserves so badly needed.

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Freedom of Commission regulation would assure the small

producer of an adequate price for the gas freed of the expense and burden of Commission regulation and refund, and would thus put the small producer in a position to assume its traditional role of pioneer in exploratory operations. If the Commission desired, the refunds so released to the small producer could be earmarked for discovery and development of gas reserves. The termination of the refund proceedings and relieving the small producer from any potential refund obligation would stimulate the exploration for further gas reserves, and would result in the discovery and commitment of additional gas reserves to interstate commerce.

Respectfully submitted,

/s/ George P. Morrill

George P. Morrill
Morrill & Patton
Attorneys at Law

GPM:mbb

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EXHIBIT "A"
To Comments of George P. Morrill
On Notice Relating to Exemption of
Small Producers from FPC Regulations

In 1960, a Family Group of small producers, comprised of a widow, three children and six trusts, owned about 30% of the gas reserves under the Normanna Field in Bee County, Texas, in Railroad Commission District No. 2. The remaining 70% was owned by majors and several independents. Negotiations for the sale of such gas were had with almost every interestate and intrastate pipe line company in the business. Finally, about 30% of the gas was sold by one of the majors to Houston Pipe Line Company for intrastate consumption for a price commencing at the rate of 16¢ per mcf, with a 2¢ per mcf escalation during each of the three succeeding five year periods. Under the terms of this contract, this gas is presently selling for 20¢ per mcf, and on October 1970 will escalate to 22¢ per mcf. The Family Group of small producers (referred to as "FG") was offered and could have made the same intrastate sale to Houston Pipe Line Company. At the same time Natural Gas Pipeline Company of America had offered FG a gas sales contract commencing at 18½¢ per mcf. In a quandry as to what to do, FG engaged competent Washington attorneys, specializing in FPC matters.

By September of 1960 the Federal Power Commission had for six fruitless years been attempting to regulate the producer on the Cost of Service Approach and everything was in a state of chaos, turmoil and confusion. On September 28, 1960, FPC rejected the Cost of Service Approach and adopted the Area Price Approach for independent producer regulation and at the same time issued its Statement of General Policy No. 61-1. The Statement of General Policy No. 61-1 (herein referred to as "61-1") established a price, which was later referred to as

"Guideline Price", of 18¢ per mcf for gas in Railroad Commission District No. 2. The whole tenor of 61-1 convinced our Washington attorneys and practically everyone in the business, that if the gas was sold at a price not to exceed the maximum rate of 18¢ per mcf in Railroad Commission District No. 2, that such price would be acceptable to the FPC and no refunds would be required. At this time it was the policy of FPC that if a refund was to be required a certificate would be issued upon the condition of refund and if a certificate was issued without any condition requiring a refund, no refund would be required. Additionally, under the law as it existed

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at such time, decided in the case of *Sunray - Midcontinent Oil Company vs. FPC, 270 Fed. 2d. 404.* FPC had no authority to direct a refund on an unconditioned Temporary Certificate. In addition, members of the FPC in various talks before interstate groups, had assured the producers that any price not exceeding the maximum prices provided in 61-1, would be accepted by FPC and would not be reduced and no refunds would be required. Acting in reliance upon 61-1, the representations of FPC, the existing case law and the belief in the inherent fairness of FPC, FG rejected the intrastate sale to Houston Pipe Line Company and entered into the contract with Natural Gas Pipeline Company of America. FG then made application for Certificate of Public Convenience and Necessity and received a Temporary Certificate, which was *issued without any condition requiring a refund.* In the acceptance of such certificate, out of an abundance of precaution, FG inserted the wording, "without obligation to refund". This acceptance was accepted by FPC and on March, 1961, deliveries were commenced. Had FG had any intimation of the trials, troubles and expenses to which they would be subjected by reason of this interstate sale, and of the complete change of position which FPC would later make in its policy toward reduction of price and in requiring refunds on unconditioned certificates, FG would never have made this sale

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in interstate commerce.

Thereafter, the distributors contested the 18¢ price and after an extended Examiner's Hearing in which a large number of other cases were consolidated, the price was reduced to 16¢ per mcf. The refund question was severed in this hearing and held in abeyance. The Examiner's Hearing was appealed and sustained by the FPC and thence upon consolidation with a large number of additional cases, was heard before the Circuit Court of Appeals and then by Consolidation with a still larger number of cases, was heard in the Supreme Court. In the Supreme Court so many additional cases had been consolidated that any specific or peculiar problems relating to any individual producer were largely lost in the shuffle. The distributors, all through the proceedings, like a pack of hungry wolves, contended for a price lower than 16¢ per mcf and strongly urged that refunds be required even on unconditioned certificates. We submit that the distributors were not as interested in protecting the interests of the consumer as they were in getting this "windfall" of refunds which they hoped would ultimately find a safe resting place in their own bank deposits. Before the Supreme Court the staff of the Federal Power Commission completely reversed its position and advocated the requirement of refunds on unconditioned certificates. One of the justices asked the attorney for the Staff, in his argument, if FPC had not assured the producers that there would be no refunds on unconditioned temporary certificates, to which the attorney replied that such was the case, but that FPC could

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not be bound by representations or estoppel. It came as quite a shock that FPC would make representations inducing producers to dedicate their gas to interstate commerce and then repudiate such representations. They felt that they had been entrapped. The Staff was advised privately that this type of conduct might result in getting refunds, but it would assuredly result in a loss

of confidence in FPC which in turn would prevent the dedication of reserves of gas to interstate commerce, and that perhaps sometime down the line these reserves might be badly needed. The Supreme Court, pursuant to the request of FPC, granted refunds on unconditioned Temporary Certificates, and pursuant thereto, FPC required refunds from both large and small producers, together with interest.

Had FG not relied upon the representations of FPC, FG would have sold its gas to Houston Pipe Line Company in an intrastate sale, would have been saved all of the tremendous time and expense involved in FPC Regulation, would have been saved tremendous legal expense, would not have been required to make any refunds, and would presently be receiving 20¢ per mcf, and beginning October 1970, 22¢ per mcf instead of 16¢ per mcf, which they are now receiving.

At great sacrifice to themselves, FG deposited the required refunds in escrow, and since this costly experience, have done very little exploration and any gas reserves found have been sold to intrastate commerce. We realize that the personnel of the FPC has changed since the events outlined above, but FG having had their fingers burned so badly, on this occasion, will probably never dedicate another cubic foot of gas to interstate commerce so long as they are under FPC regulation. The refunds so held in escrow at this time will have practically no effect upon the price of gas to the ultimate consumer. As a matter of fact, because of the many defects in the refund procedure, it is highly unlikely that these monies would ever be "flowed through" to the consumer, but will come to rest in the pockets of the distributor, as the windfall to which the distributor is not entitled and which will serve no useful purpose.

There is a possibility of deeper gas reserves under the Normanna Field. These reserves are not committed to interstate commerce and so long as small producers are subject to FPC regulations there is absolute certainty that if such additional gas

reserves are found and developed, that they will not be dedicated to interstate commerce.

[73]

Over the years FG have done a tremendous amount of wildcat, exploratory drilling and have been successful in discovering considerable gas production. If they are exempted from FPC Regulation it will stimulate their development operations, will no doubt result in the discovery of additional gas reserves, and with the assurance of a firm price and no refunds, will probably result in the dedication of such gas to interstate commerce. But, unless they are exempted from FPC regulation, with the experience which they have had, their exploration, if successful, will go to intrastate commerce. Accordingly, we strongly recommend the exemption of small producers from FPC regulation as proposed in the Notice of Proposed Rulemaking, Docket No. 393, and the release to the small producer of any refunds required, or in escrow in any pending proceedings.

/s/ George P. Morrill

George P. Morrill

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UNITED STATES OF AMERICA

BEFORE THE

FEDERAL POWER COMMISSION

In the Matter of:	)	
	)	
Exemption of Small Producers	)	Docket No. R-393
From Regulation	)	

VIEWS AND COMMENTS

Come now HUNT OIL COMPANY, H. L. HUNT, HASSIE HUNT TRUST, CAROLINE HUNT SANDS, LAMAR HUNT, W. H. HUNT, N. B. HUNT, SECURE TRUSTS, A. G. HILL, HIDALGO GAS PRODUCTION CORPORATION, C. M. LANGTON, TRUSTEE, ALINDA HUNT HILL TRUST, HUNT PETROLEUM CORPORATION, HUNT INDUSTRIES, W. H. HUNT TRUST ESTATE, N. B. HUNT TRUST ESTATE, LAMAR HUNT TRUST ESTATE, H. L. HUNT, JR. TRUST ESTATE, CAROLINE HUNT TRUST ESTATE, LYDA HUNT-CAROLINE TRUSTS, LYDA HUNT-BUNKER TRUSTS, LYDA HUNT-LAMAR TRUSTS, LYDA HUNT-HERBERT TRUSTS, LYDA HUNT-MARGARET TRUSTS and PLACID OIL COMPANY, hereinafter jointly referred to as "Hunt, *et al.*" and submit, in response to the Notice of Proposed Rulemaking issued by the Commission on July 23, 1970, their views and comments relative to rules proposed to be promulgated in the captioned proceeding.

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For the reasons hereinafter set forth Hunt, *et al.* supports the Commission's proposed exemption of small producers from

rate regulation as a step in the right direction but offers certain suggestions for improvement of the proposal:

In support hereof, Hunt, *et al.* would show the following:

I

Small producers are, and have long been, of vital importance to the nation's natural gas producing industry. Although it is said that they account for only ten percent of all jurisdictional natural gas sales[1] their production cannot be considered of little importance on an area basis[2]. Most important is the small producers' contribution in exploring for new gas supplies wherein they account for approximately 80 percent of all exploratory well drilled.[3]

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In their exploratory efforts they frequently drill prospects deemed too risky by the larger producers when viewed in the context of potential reserves to be discovered. Their drilling efforts often prove or disprove the presence of gas bearing structures, and the information gained is useful to all producers, large and small, in their search for new gas supplies. And yet, it is upon the small producer that the burden of regulation has weighed most heavily. Under the Commission's present cost based rate making system only the costs of the largest producers

[1]Response of Federal Power Commission Staff; Initial Rates for Future Sales of Natural Gas for All Areas; Docket No. R-389A (Page 24)

[2]Opinion No. 468, p. 12; Area Rate Proceeding, Docket Nos. AR61-1, *et al.*

[3]The record of the Southern Louisiana Area Rate Proceeding (Docket No. AR61-2) shows that small producers drilled 78.1% of all wells drilled in 1960 (T. 23,923-8) of which 31% were exploratory wells. Of the remaining wells drilled only 17% were exploratory wells. (See also Exhibit 181.)

are considered while small producer costs are ignored. This procedure of basing rates upon large producer costs is especially inappropriate for small producers since their costs are uniformly higher than those of larger producers.[4] These higher costs are due to their unique methods of operations founded upon a higher percentage of exploratory drilling, always expensive and extremely risky, and smaller lease holdings which necessarily support smaller reserves when drilling is successful. Full

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participation in area rate making proceedings is never feasible for small producers, and minimal compliance with the Commission's certificate and rate change procedures in disporportionally burdensome. It is known that many of the smaller producers are not receiving the rates for their gas sales to which they are entitled by contract simply because they are not sufficiently familiar with the Commission's procedures to know that they must file for higher rates. For each of these reasons Hunt, *et al.* is of the opinion that the exemption of small producers is warranted and supports the Commission's proposal.

While supporting the Commission's proposal in general, certain comments are hereinafter made which should be given serious consideration prior to the adoption of the proposed rules.

II

In its commentary on the proposed rules the Commission states:

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[4]See Exhibit 23—Area Rate Proceedings (Southern Louisiana) Docket No. AR61-2. See Exhibits 68-J and 69-J Area Rate Proceedings (Hugoton-Anadarko and Texas Gulf Coast) Docket Nos. AR64-1 and AR64-2.

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> "The exemption for small producers proposed here would include, *inter alia*, jurisdictional sales made by a small producer to a large producer. However, the resale of such gas by the large producer would remain subject to our jurisdiction." (page 3)

It is not uncommon for one producer to sell gas to a second producer who, after performing a transporta-

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tion, compression or processing service, resells the gas to an interstate pipeline. In this arrangement the second producer contracts to seel the gas at a rate slightly higher than he pays the first producer for the gas. This price spread compensates the second producer for the services he performs for the benefit of the first producer. Under this fact situation, if the first producer is established as a "small producer" and thus exempted from rate regulation, he can receive the full contract rate for his gas sold to the second producer. If however, the second producer does not qualify as a small producer, his resale of the gas purchased would be subjected to regulation and the possibility of being prevented from realizing his contractually supported rate. Should he not be permitted to collect and retain his contract rate, the negotiated contract price spread would be lost and the profitability of the project impaired. In effect these circumstances would be to require the second producer, the large producer, to fund the small producer's exemption. This would be patently unfair and probably unlawful. It appears that there are two possible solutions to this problem. They are: (1) deny the small producer's exemption or (2)

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permit the second producer to collect his resale rate without

refund obligation insofar as the resold gas originates from small producers. Hunt, *et al.* favors solution (2). In no event should the second producer be restrained, by rate change moratorium or otherwise, from *collecting* his full contract rate.

III

Proposed Section 157.40 defines a "small producer" as one "who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of 'affiliated producers' are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year." Hunt, *et al.* submits that the line of demarcation between small producers and large producers was arbitrarily established by the Presiding Examiner in his Initial Decision in the Permian Basin Proceeding[5] and subsequently has been arbitrarily adopted by the Commission.[6] Hunt, *et al.* does not object to the use of the 10 million Mcf dividing point on an interim basis but urges the Commission to undertake imme-

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diately to determine the proper dividing point between the two producer classifications. There are significant differences between small producers and the larger producers. These differences should be defined and appraised before a permanent dividing point is established. For example, Hunt, *et al.* sponsored studies have shown that the larger the size of the producer in terms of gas volumes sold, the lower is its costs.[7]

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[5] 34 FPC 306 at 361–termed "the practical dividing line."

[6] 34 FPC 159 at 235–Permian Basin Decision 40 FPC 530 at 612–Southern Louisiana Decision

[7] See Exhibit 243 (Excluded) accepted as Offer of Proof; Area Rate Proceeding (Southern Louisiana Area) Docket No. AR61-2. See also exhibits described in footnote 4, *supra.*

Accordingly, cost differences should be a factor for consideration. Smaller producers can neither acquire and hold large lease blocks as can larger producers nor can they drill wells in sufficient numbers to take advantage of the averages relative to successful exploratory completions. They always have less financial depth than do large producers and must endure greater financial risks. Often they have less bargaining power with prospective purchasers of their gas and obtain less favorable terms due principally to the fact that they usually develop smaller gas reserve packages. All of these factors should be considered prior to establishing permanently the dividing point. It is the

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considered opinion of Hunt, *et al.* that once completed such study would show that the proposed dividing point of 10 million Mcf annually is much too low and not supportable by presently available facts. It is believed that an adjustment upward to 25 million Mcf annually would be found to be more reasonable and more easily supported by existing facts.

IV

At pages 3 and 4 of the Notice of Proposed Rulemaking the Commission stated that it had not "proposed any disposition of increased rates collected subject to refund in Section 4(e) cases or initial rates collected under temporary certificates issued pursuant to Section 7 by small producers for the period prior to the effective date of the exemption." It further stated that the proceedings to which it was referring were those where the Commission had yet taken no action and none was pending as a result of an examiner's decision. Comments were invited on this point.

It is the view of Hunt, *et al.* that small producers should be relieved of all refund obligations at the time they are granted exemptions. This view is consistent with the other positions taken by Hunt, *et al.* herein and consistent with the Commission's recognition

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of the many differences between large and small producers which support more favorable treatment of the small producers. If exemption, and the right to collect contract rates as the result of that exemption, is determined to be justified for the future based upon conditions presently existing and known to exist in the past it would seem appropriate for the Commission to apply the rationale supporting that exemption to existing rates of small producers now burdened with a possible refund obligation and remove the refund conditions. This view is offered, however, only upon the premise that under no circumstance should a large producer be required to fund the small producer price advantage as discussed in Section II hereof.

V

Correspondence with regard to the foregoing views and comments may be addressed to:

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Hunt Oil Company, *et al.*
1401 Elm Street
Dallas, Texas 75202

Attention: Mr. Robert W. Henderson

and

Placid Oil Company
2500 First National Bank Bldg.
Dallas, Texas 75202

Attention: Mr. Paul W. Hicks

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WHEREFORE, Hunt, *et al.* respectfully requests that the Commission give studied consideration to the views and comments expressed herein and grant the proposed exemption of small producers in accordance therewith.

Respectfully submitted,

/s/ Donald K. Young
DONALD K. YOUNG
ATTORNEY FOR
HUNT, *ET. AL.*

September 4, 1970

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* * * * *

[COMMENTS OF JAMES M. FORGOTSON, SR.]

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QUESTION PRESENTED

Whether [the] decision in the case of *Phillips Petroleum Co. v. State of Wisconsin*,[2] applying the provisions of the Natural Gas Act[3] to independent producers of unprocessed unassociated and casing-head gas, should be reversed, because in light of later actual experience and economic and technological changes such application now constitutes such invidious and arbitrary discrimination against said independent producers that the application violates their guarantees of equal protection of the law.

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STATUTES INVOLVED

Section 1 (b) of the Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. § 717 (b) is involved and is reproduced * * * in our Appendix.

CONSTITUTIONAL PROVISIONS INVOLVED

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[2]347 U.S. 672 (1954)

[3]15 U.S.C. 717 (b), *et seq.*

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Constitution of the United States, Amendment V:

> "No person shall . . . be deprived of life, liberty, or property, without due process of law . . ."

Constitution of the United States, Amendment XIV, Section 1:

> "No state shall make or enforce any law which shall . . . nor deny to any person within its jurisdiction the equal protection of the laws."

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The Court of Appeals Opinions. Since this petition attacks the very jurisdiction of the Federal Power Commission over independent producers of unprocessed unassociated or casinghead gas on constitutional grounds, the specific rulings * * * are not relevant. However, as set forth fully in the next portion of the petition, the continued application of a public utility regulatory process to independent gas producers by the Federal Power Commission * * * along with the misclassification of utility-distributors as consumers or consumer interests * * * significantly affect the importance of [this comment].

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REASONS * * *

1. Importance of this case to all segments of the natural gas industry and all classes of consumers cannot be overstated. A shortage of natural gas already exists. That shortage is directly involved in this case * * *.

The gas supply situation is greatly affected by the rates prescribed by the Federal Power Commission in this case and the regulatory process imposed on sales for resale in interstate commerce by independent producers of unprocessed unassociated or casing-head gas by this Court's decision in *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954). In fact the supply situation is more affected by the last mentioned item than by anything else. Thus, reconsideration and reversal of the regulatory process instituted by this Court in *Phillips Petroleum Co.* v. *State of Wisconsin, supra*, are indicated for the important reasons which are set out below.

2. Even former decisions of the United States Supreme Court sustaining the constitutionality of a specific state police regulation do not preclude bringing subsequent suits to test their validity in light of later actual experience, because regulations, valid when made, may become arbitrary and confiscatory in operation by reasons of later events. See *Abie State Bank* v. *Weaver*, 282 U.S. 765 (1931).

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* * * [T]he issue itself goes to the very jurisdiction of the Federal Power Commission over the subject matter of the case. * * *

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3. The application of FPC price ceilings on sales for resale in interstate commerce of unprocessed unassociated and casing-head gas produced by independent producers is an unconstitutional discrimination against the independent producer. In light of current and evolving technology and economics in the fuel and energy industry, the application of the provisions of the Natural Gas Act of 1938 to any of the sales of unprocessed unassociated and casing-head gas by independent producers constitutes unconstitutional invidious discrimination. This discrimination is against independent producers in favor of distributor-utilities both of whom are *suppliers and not consumers* in the natural gas *supply industry*, and against these same producers in favor of producers of fuels and energy sources other than unprocessed unassociated and casing-head gas, i.e., oil, liquid petroleum condensate, liquid petroleum gas, coal, and lignite producers, who are all part of the nation's energy industry. Because such discrimination is invidious, application of the Act to independent gas producers would be a violation of constitutional guarantees of Equal Protection of the Law, and thereby be violations of the Fifth Amendment of the Constitution. Equal Protection of the Law guarantees are provided against discriminatory acts of the Federal Government through inclusion of equal protection guarantees within the Due Process Clause of the Fifth Amendment. See *Brown* v. *Board of Education of Topeka*, 347 U.S. 483 (1954) and 349 U.S. 294 at 298 (1955), which by implication applied equal protection clause provisions

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to end racially segregated schools in the District of Columbia, which are governed *by federal, not state law.* The Court stated that all provisions of *federal,* state or local law requiring or permitting racial discrimination in public schools must yield. 349 U.S. 294 at 298.

4. Legal creation of closed classes through economic regulatory programs which advance the economic interests of the closed classes constitutes a violation of the Equal Protection of the Law guarantees of the Federal Constitution.

The most recent United States Supreme Court decision applying constitutional Equal Protection of the Law guarantees (of the Fourteenth Amendment) to invalidate economic regulation was the case of *Morey* v. *Doud,* 354 U.S. 457 (1957). Our contention is that application of FPC price ceilings to wellhead sales of unprocessed unassociated and casing-head gas by independent producers comes within the purview of the rule for applying equal protection guarantees to invalidate economic regulations announced in *Morey* v. *Doud, supra.* This is in spite of (1) the now substantially undisputed power of Congress to pass *nondiscriminatory* economic regulatory legislation under the Commerce Clause of Article I of the Constitution (*N.L.R.B.* v. *Jones and Laughlin Steel Corp.,* 301 U.S. 1 (1937); and *Wickard* v. *Filburn,* 317 U.S. 111 (1942); and (2) the equally undisputed decisions that such regulation either by the States or the Federal Government does not constitute a taking without due process of law. (*Federal Power Commission* v. *Natural Gas Pipeline Company,* 315 U.S. 575 (1942); *Nebbia* v. *New York* 291 U.S. 502 (1934)).

* * * * *

In *Morey* v. *Doud, supra,* a three-judge District Court was upheld by the United States Supreme Court in enjoining enforcement of the Illinois Community Currency Exchange Act of 1943 because said Act violated the

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Equal Protection Provisions of the Fourteenth Amendment.

The Act in question provided a comprehensive system for licensing and regulation of community for-fee check cashing services and issuers of money orders and made operation of an unlicensed establishment a crime. In order to obtain a license

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these establishments were required to pay both licensing and investigative fees, furnish information to the Illinois State Auditors Office, maintain specified amounts of cash on hand and possess surety bonds in specified amounts. In addition, each exchange had to be an entity financed and conducted as a separate business entity. Finally, a license could not be issued unless the State Auditor determined that its issuance would promote a convenience and advantage to the community. The American Express Company and its money orders were explicitly exempted from the provisions of the Act.

In sustaining the lower court by a 6-3 vote, the majority of the United States Supreme Court made the following points clear with respect to application of Equal Protection Clause provisions to economic regulatory legislation:

a. The prohibition of the Equal Protection Clause goes no further than *invidious* discriminations.

b. The Equal Protection Clause does not take from the States the power to classify in the adoption of policy laws.

c. The Clause permits the exercise of a wide scope of discretion in classification and prohibits only those that are purely arbitrary.

d. The practical result of some inequality in application of the regulation is not sufficient to invalidate the regulation.

e. The Complainant must carry the burden of showing that the law in question does not rest upon any reasonable basis, but is essentially arbitrary.

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f. Provisions to be valid *cannot single out any company or group of companies,* irrespective of their unquestioned reputations, and create a closed class with the accompanying economic advantages to such company or group.

The creation of a *closed class with the accompanying clear economic advantage given to that class* was the fatal defect in the Illinois Act and will be the basis of any further application of the Equal Protection guarantees to invalidate economic regulation, state or federal. *Morey* v. *Doud, supra,* has never been overruled by the United States Supreme Court.

This question subsequently has come before State Supreme Courts, none of which have departed generally from the basic 1957 rule, although most have failed to find *creation of a closed class in the facts presented* and thereby have not invalidated the legislation. See, *e.g., Donohue* v. *O'Connell's, Inc.*, 164 N.E. 2d 52, 18 Ill.2d 432 (1960)

Consequently, our theory is that the application of the Natural Gas Act of 1938 to gas sales of unprocessed unassociated or casing-head gas by independent producers creates *closed* classes or groups which are given accompanying clearcut economic advantages, making this application constitute *invidious* economic discrimination or class legislation.

5. Application of the Natural Gas Act and Federal Power Commission price ceilings to independent producers creates a closed class, the retail distributors in the natural gas supply industry, and invidiously discriminates against the independent producers in favor of the distributor-utilities.

The Court in the case below has classified the parties to natural gas regulatory litigation as producers, consumers and the Commission (meaning the Federal Power Commission). See Continental Appendix A, pp. 1-2.

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It has classified producers and pipeline companies as producers, utility-distributors as consumers or consumer interests, and the Commission as the Commission. No argument can be had with classifying the Commission as the Commission. From that point

onward, however, the court below has been in error. In reality the three classes are: Suppliers (which includes *producers, transporters and distributors);* Regulators, which balance the interests of consumers and suppliers in the interests of social and economic justice (which includes at least the Federal Power Commission and state public utility or service commission and which *should* include the conservation commissions of the states); and Consumers, e.g., housewives or industrial enterprises using gas as process fuel or heat source. This error has resulted in *identifying* (as was made abundantly clear in the case below) producers and distributors as members of *different* classes, thereby permitting vastly *unequal and inappropriate* regulatory treatment of the independent producers.

It is our contention that this error, which was so clearly illustrated in the case below, has resulted in placing a discriminatory burden on one of the members of the *Supplier* group in order to protect another member of that *same group* from that member's own frequent lack of aggressiveness and continu..' operations under many, often anachronistic state regulatory laws on the grounds that this is protecting the consumer interest. The latter interest actually is a far different species from the *interest* of the retail public utility-distributor who is frequently an entrepreneur operating at a profit with substantial earnings.

To do this legislatively goes beyond mere lack of wisdom, providence and harmony with a particular school of thought. See *Williamson* v. *Lee Optical Co. of Oklahoma*, 348 U.S. 483 (1955). It constitutes legislation which in light of current conditions is arbitrary and in-

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vidiously discriminatory. It has created a closed class of entrepreneurs within the supplier group (the distributors who already have a regulated natural monopoly), who are subject to risks in no way comparable to those of the independent producer of

unprocessed unassociated or casing-head gas. The distributors earn a guaranteed rate of return for their security holders and have a competitive advantage against other energy sources, because of their being able to buy their raw material (either unassociated or casing-head gas in an untreated, unprocessed state) at a controlled maximum price, free from market forces.

What has occured is that one unit (the independent producers) in the supplier group is in fact being regulated as a public utility, which in fact it is not. Such regulation has been evolving for nearly 17 years, to protect the interests of the utility-distributors who hold a natural monopoly and whose interests have been judicially mis-identified with the consumers.

The results of this error have been extremely serious and clearly not in the best interests of the consumers. This error has contributed to a fuel shortage, particularly a shortage of natural gas, with a possibility of natural gas rationing among consumers and importation of liquefied natural gas from foreign countries at prices at least two or three times higher than the current or contemplated price ceilings imposed on U.S. producers. Although this only goes to the wisdom rather than the constitutionality of the application of the Natural Gas Act and governmentally imposed price ceilings on independent producers, it puts the issue into clearer perspective.

In dealing with the constitutional question of equal protection, it is our contention that the Congress, by imposing a form of public utility regulation on natural gas producers, which the United States Supreme Court *later*

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clearly stated are *not* public utilities,[6] has not only misclassified producers, but also has put them under a regulatory program

[6] See *In re Permain Basin Area Rate Cases*, 390 U.S. 747 (1968).

which invidiously advances the conomic interests of the distributor by trying to assure him a supply of raw material at lower than free market costs. Consequently, the distributors can make a profit and expand their sales volume while (1) failing to take significant aggressive steps, on a sufficiently realistic scale to work toward adequate supplies at competitive prices, and (2) operating under anachronistic state regulatory laws, which they make no effort to change.

To meet the test of equal protection all members of the group should be treated alike to the greatest extent possible. The test does not require either comprehensiveness of regulation or absolute or mathematical equality of treatment. Neither does it require dealing with all facets of the problem at the same time, but allows legislative discretion to "attack some evils before attacking others." Nevertheless, equal protection does not or should not *permit* one member of a group to be regulated in order to advance the economic interest of another group in the same class without clear justification. In the current situation, one member of the supplier group is advanced at the expense of *another* and the consumer as well.

It might be argued that no discriminatory treatment exists since both independent producers and distributors are public utilities. There is no question about the propriety of treating distributors with regulated natural monopolies as public utilities and imposing some public utility regulatory procedures upon them. That public utility regulatory procedures for independent producers is not appropriate was made clear by Mr. Justice Harlan in the *Permian Basin Area Rate Cases, supra,* and by Judge Thornberry in the case below.

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The issue then becomes whether the inevitable result of any governmental price ceilings imposed upon independent producers of unprocessed unassociated or casing-head gas must *perforce,* regardless of freedom of the Commission to experiment,

be public utility treatment and be inappropriate. Our contention is that the answer to this question is yes and that the treatment is so inappropriate as to be invidiously discriminatory. This is because if a group which has no characteristic of a public utility with a natural monopoly is nevertheless regulated as one with the end result of advancing the economic interests of another unit in the same group (the supplier group), then there is invidious discrimination.

The courts in the abstract thus far have answered the above question as *no* by saying that the Commission *need abide by no fixed formula and can pragmatically adapt policies and procedures to meet changing conditions.* Our contention is *that as a practical matter the answer will inevitably be yes, because this is all that a regulatory agency like the Federal Power Commission can do.* It can develop formulas *ad infinitum,* but they all have been and *perforce* will be based on allowing some "fair" rate of return on capital and operating costs with or without added nonmarket incentives to stimulate exploration and development of reserves.

The Federal Power Commission's actual performance up to the present substantiates our conclusion.

In all of the gas rate cases the only real controversies involve what should be allowed as capital costs, what are operating costs, what should be allowed as a fair return on an investment (including such questions as whether expenditures for dry holes or gas of less than pipeline quality constitute costs or risks) and should incentives for exploration be allowed, and if so how much. These are all classical public utility regulation questions, whether they be based on (1) producer by producer or well by well

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costs, (2) area-wide average costs, or (3) nation-wide costs with

special consideration given to exploration and development incentives to encourage the finding of new gas. It is also public utility regulation whether historic costs or projected costs are used as the basis for calculating a "fair" return. In spite of all protestations to the contrary, this is all the Commission or any commission can ever do when it regulates by imposing price ceilings on independent producers.

The Fifth Circuit * * * said that the Federal Power Commission has the power to set prices on the basis of costs and that market variables do not necessarily have to influence the calculation, but that the Commission must examine even a cost computed rate against the ultimate statutory purposes it is supposed to be carrying out. * * * The Court in its dictum went on to say that it advocated a mixture of market (supply and demand factors) and cost computed rates to regulate industry performance.

It prescribed the following steps to be taken by the Federal Power Commission in arriving at the price ceilings:

(1) estimation of needs for consumer service—demands for gas;

(2) use of the above estimation to fix the level of service aimed at, explaining how the level of service aimed at is related to estimated demand in case demand is not to be fully satisfied by the regulatory program; and

(3) making findings as specifically as possible as to how the rate it has set will affect the industry's tendency to meet the level of service, i.e., what supply rate will be brought forth, while at the same time preventing the occurrence of excessive prices.

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This is fine theory. However, econometrics is an inexact science, at best, and the ultimate practical result will always be a cost-computed ceiling with some *lagniappe*, supported by some econometric theorizing and forecasting for its justification, thrown in. Whether this *lagniappe* added to standard public utility cost-computed prices is adequate, as a practical matter, to maintain a healthy industry is almost purely a matter of guesswork. This will be the case if anyone will realistically look at what can be done with the science of econometrics *with currently available data and data collection methods and facilities, with even the most advanced estimation techniques.* The result will be actually some variation of standard public utility regulation for a group with none of the characteristics of a public utility.

Consequently, whether the Federal Power Commission has evolved a potentially workable regulatory procedure after nearly seventeen years or not, is really not material. Whatever they develop will be a public utility regulatory procedure which is a *prima facie* wrong approach for regulation of independent producers of unprocessed unassociated or casing-head gas. When this is coupled with the use of the regulatory process to advance the economic interests of another supplier unit, the retail distributor, who has a guaranteed market and the advantages of a natural but regulated monopoly, it constitutes invidious discrimination and violates the guarantees of equal protection of the law *unless some clear-cut justification for its exists.*

This leads then to the question of where or what is the justification?

The major apparent justification is that the "end result" brings lower or more slowly increasing prices of energy to the consumer. Obviously, such an "end result" could be accomplished by better management of the utility-distributors, better

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stoves or furnaces, better state regulation of utility-distributors (including more

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modern state regulatory statutes), improved capitalization of utility-distributors, mergers of some distributors to bring about more capital and a better inflow of management and technology, etc.; consequently this justification is arbitrary.

If achieving an end result by a means that results in invidious discrimination against one unit of the supplier group (the producer) to advance the economy of another supplier (the distributor) rather than a more equitable and less discriminatory alternative means is used, then the discriminatory means should be held to violate the guarantees of equal protection of the law and be declared invalid.

That protection of economic interests by the Due Process Clauses of the Fifth and Fourteenth Amendments should not be abandoned has been recently restated with great clarity. See Streuve, The Less Restrictive Alternative Principle and Economic Due Process, 80 Harv. L. Rev. 1463 (1967). The author delineates the less restrictive principle and advocates a return to its use by the Supreme Court as an independent ground for invalidating over-broad regulations to permit a better balancing of interests between private parties and the government. The principle is that an economic regulation violates due process if the government has a less restrictive alternative. In dealing with regulations of personal freedom not involving either freedom of expression or civil rights, the United States Supreme Court also indicated that a test of the less restrictive and burdensome alternative on those regulated to accomplish the legislative end sought was required by the Constitution. See *Griswold* v. *Connecticut*, 381 U.S. 479 (1965).

The only other possible justification would be the monopolistic nature of the unprocessed unassociated and casing-head gas sales market at the wellhead. This is discussed more fully later, and it can be clearly stated

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that no monopolistic situation exists. This fact was further emphasized by Mr. Justice Harlan speaking for the majority in the *Permian Basin Area Rate Cases* when he characterized producers as "intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded search," 390 U.S. 747 at 757 (1968).

That the distributor utilities are a natural monopoly and subject to state regulation on a cost derived basis and that long-line interstate processed natural gas pipelines frequently integrated with their own production facilities might have shown monopolistic tendencies in 1938 and afterwards at the state of both technology and the economy then, and needed regulation because they were immune from state regulation, does not justify imposition of public utility regulation on non-integrated independent producers' sales of unprocessed unassociated and casing-head gas at the wellhead *today* to curb a monopolistic situation.

6. By singling out producers of unprocessed unassociated or casing-head gas for governmental price ceilings, the Federal Government has given a clearcut economic advantage to producers of competing fuels and created a clearcut closed class, i.e., producers of other fuels, whose economic interests are advanced by the regulation without clear justification.

Unprocessed unassociated or casing-head gas is a fuel or energy yielding commodity just like coal, lignite, oil, liquid petroleum condensates, liquid petroleum gases and uranium which

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compete with it in the national energy market. Consequently, by singling out this one unprocessed commodity for governmental price ceilings on independent producers, a closed but large economic class is created with concomitant economic advantages. Creation of such a class constitutes invidious discrimination and violates equal protection guarantees unless the unique

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treatment is justified. Consequently, the issue is, is there any unique characteristic of unprocessed unassociated or casinghead gas or independent producers thereof to justify this classification.

a. Transmission or transportation.

In this country because of advances in technology, particularly that related to transmission of fuels, coal and lignite slurries as well as natural gas, oil, liquefied petroleum condensates and liquefied natural gases can and are now being transported by pipelines in interstate commerce, either for use or resale at their remote destination. Coal, lignite, oil, liquid petroleum condensates, liquid petroleum gases, and heavier so-called bottle gases (e.g., butane and propane) are also sold either at the wellhead, mine shaft, excavation pit, refinery, or gas processing plant to pipelines for interstate transmission and subsequent resale or sold directly to customers, not for resale, who then use pipeline facilities to transmit the product or commodity to locations in distant states for use as fuels or energy sources. Furthermore, natural gas (methane) itself can be liquefied and shipped via railroad tank car, truck, barge or ocean-going tanker rather than by a pipeline to interstate or foreign destinations either for resale or direct use, just as other hydrocarbon or fossil fuels and the nuclear fuel uranium can be shipped. As a result there is nothing unique about unprocessed unassociated or casing-head gas or its producer's in these characteristics which separates

them from other fossil fuels or nuclear fuels. The independent producers simply supply a commodity to provide energy.

b. **Scarcity and wasting asset nature of natural gas.**

It can be assumed that natural gas is a wasting asset, in actual or potential short supply in the United States. So are coal, lignite, oil, liquid petroleum condensate, liquid petroleum gases and uranium. Consequently, unproc-

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essed unassociated or casing-head gas and its producers have no unique characteristics in this regard.

c. **Influence of price of commodity at wellhead on end price of service or consumer use.**

It can also be assumed that the price of unprocessed unassociated or casing-head gas at the wellhead influences the retail price of fuel or energy to both domestic and industrial consumers. So do the prices of all other fuels or energy producing commodities such as coal, lignite, oil, liquid petroleum condensates, and uranium. Similarly, it must be assumed that the price of the actual service, i.e., end product of commodity use (e.g., cooking, winter heating, electrical generation, industrial process heating), is also highly determined by the price of such items as household gas ranges, gas furnaces, boilers, steam turbines and nuclear reactor components. Consequently, unprocessed unassociated or casing-head gas or independent producers thereof, are not unique in that respect.

d. **Uniqueness because of characteristics of retail distributors of the commodity.**

It can also be assumed that unprocessed unassociated or casing-head gas for both domestic and industrial use is actually

usually distributed (after processing and shipment from the well) to ultimate consumers (domestic and industrial) by natural monopoly public utility distributor companies who are closely regulated as to prices and practices by state and in some cases county or municipal statutes, ordinances and regulations, whether the gas goes to the consumers as gas or is used as boiler fuel to generate electricity. So are oil, coal, lignite, liquid petroleum condensates and nuclear fuels when they are used to generate electricity or produce centrally generated piped-in steam for heating or industrial or other purposes. Only when gas goes as gas for actual burning by the consumer does it differ from oil,

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coal, lignite, liquid petroleum condensates or uranium in being distributed by a legally regulated natural monopoly—i.e., a public utility company. Even then, it is sold by the regulated utility company *in competition* with electricity (such as for domestic heating, cooking or cooling), which itself is in many cases distributed by the *identical* utility company that distributes the gas for similar purposes.

e. Natural gas is the ideal fuel and consequently production by independent producers requires unique treatment.

It must also be assumed that methane-natural gas (unassociated or casing-head gas after processing to remove such things as water, sulfur, carbon dioxide, helium, associated liquid hydrocarbons and heavier gaseous constituents such as ethane, propane and butane) is a very excellent fuel in that it has a high BTU value per unit volume (averaging about 1,000 BTU/cubic foot), and burns without fly ash or sulfur oxides, and without many products of incomplete combustion such as hydrocarbon radicals and carbon monoxide. This makes it a virtual nonpolluter as far as air pollution problems go. However, nuclear

fuels produce no fly ash, sulfur oxide or other hydrocarbon combustion air pollution products and have a much higher BTU content per unit consumed (whether by weight or volume). Moreover, both refining and combustion processes are being developed to decrease markedly the pollution problems caused by oil and work is proceeding rapidly on developing "synthetic" natural gas by hydrogenation of coal. Consequently, processed (methane) gas is an excellent fuel but is by no means the ideal fuel. Nevertheless, because of quality, convenience and price (which is artificially lowered by Federal Power Commission Regulation of the commodity), processed gas-methane is a preferred fuel with a growing demand.

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f. Monopolistic characteristics of independent producers.

Finally, *independent* production of and sale of unprocessed unassociated or casing-head gas at the wellhead, as distinguished from its processing, transportation and distribution and sale to ultimate consumers, is not monopolistic, but competitive. The competition is as great or greater than among other fuels such as coal, lignite, oil, liquefied petroleum condensates, liquefied petroleum gas, and uranium, in addition to other industries such as automobiles. Independent production is not a natural monopoly like the public utility-distributors are, nor a potential monopoly as a result of economic combinations, collusions or other forces. Such things as transporters, integrated transporter-producers, or integrated distributor–producer-transporter combines could be and might justify special legislative treatment.

As a matter of fact, in 1970, according to the Federal Power Commission itself, there were over 4,600 independent producers engaged in interstate sales of natural gas for resale and 70 independent producers controlled a total of approximately 85 percent of the interstate, sale for resale *market* nationwide. See Federal Power Commission Notice of Proposed

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Rulemaking (Exemption of Small Producers From Regulation), Docket No. R-393, July 23, 1970. Furthermore, new firms are entering the interstate sale for resale market. In 1962, 10 percent of this particular market was occupied by firms entering after 1960. See Hodges, Natural Gas: Price Regulation vs. Supply, unpublished Richard J. Gonzalez Lecture, April 23, 1970, College of Business Administration, University of Texas.

If production rather than markets is analyzed, the four largest producers at the national level controlled 32.1 percent of production and the eight largest producers controlled 37.6 percent of production as of 1962. By way of contrast, the production concentration for the four largest producers of all products in the United

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States was 40 percent, with many basic industries such as automobiles, copper, soap, glass, electric light bulbs, and photography equipment showing production concentration of 90 percent or above among the 4 largest producers of each product. See Hodges, *supra*.

Even disaggregating the national market on a regional basis, the top four gas producers in 1962 controlled only 24.7 percent of the Gulf Coast regional market for interstate sales, and 22.9 percent of the Mid-Continent-Permian Basin regional market for interstate sales for resale. Furthermore, the big four in the Gulf Coast Region are not necessarily the same big four in the Mid-Continent-Permian Basin Area. See Hodges, *supra*.

Since other fuels are substitutable for natural gas as fuels for both domestic and industrial use, the monopolistic argument is even less valid. In fact, the independent producers of unprocessed unassociated or casing-head gas were described by Mr. Justice Harlan as "intensely competitive vendors of a wasting commodity they have acquired only by costly and

often unrewarded search." See, *In Re Permian Basin Area Rate Cases*, 390 U.S. 747 at 757 (1968). Consequently, natural gas production and producers cannot be classified as unique from other fuel and energy source commodity producers such as coal, lignite, oil, liquid petroleum condensate or uranium in terms of monopolistic characteristics.

g. Conclusions

Because of the above factors, legislative classification of independent producers of unprocessed unassociated or casing-head gas appears to be more than *unwise, improvident or out of harmony with a particular school of thought.* If it were *only* those the classification would not meet the test necessary for constitutional invalidity. See *Williamson* v. *Lee Optical Co. of Oklahoma, supra.* Instead it appears to be clearly arbitrary.

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This arbitrary classification of independent gas producers has created a closed class of unregulated fuel producers and is invidiously discriminatory against the regulated independent producers, because all are producers of a similar commodity, and only one has been singled out for federal price ceilings.

This is not to say or even imply that the Natural Gas Act of 1938 is unconstitutional or even that its application to regulate prices of gas "sold" by integrated producer-transporter companies to themselves or their subsidiaries on a non-arm's length basis are unconstitutional. It is the application of the Act to the independent producers that is unconstitutional.

* * * * *

Respectfully submitted,

/s/ EDWARD H. FORGOTSON

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Counsel for
[James M. Forgotson, Sr]
[September 14, 1970]

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APPENDIX A

Title 15 § 717 (b), U.S.C.

(b) The provisions of this Chapter shall apply to the transportation of Natural Gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

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BEFORE THE

FEDERAL POWER COMMISSION

In the Matter of	Docket No.
EXEMPTION OF SMALL PRODUCERS FROM REGULATION	R-393

VIEWS AND COMMENTS
OF
TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC.

Pursuant to the Notice of Proposed Rulemaking issued by the Federal Power Commission in Docket No. R-393 on July 23, 1970, Tennessee Gas Pipeline Company, a Division of Tenneco Inc., (Tennessee) submits the following views and comments in response to the proposed Regulations.

I

In this rulemaking proceeding the Commission proposes Regulations which, with the exception of an annual reporting requirement, will totally exempt "small producers" from regulation under the Natural Gas Act. The main purpose of the proposed rule, as stated by the Notice, is to "relieve small producers in all areas of almost all the expenses and burdens connected with regulatory matters . . . and to encourage them to increase their exploratory efforts . . ." While Tennessee supports the Commission's efforts to reduce the burdens of and simplify "small producer" regulations, it feels that the subject proposal will raise several perplexing problems.

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II

The basic problem with the Commission's proposal, and which, no doubt, will cause much future confusion in the event the proposed rule is adopted, is the apparent lack of statutory authority for the Commission to exempt "small producers" from regulation under the terms of the Natural Gas Act.

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In the Notice the Commission states that the ground work for the proposed exemption was formulated in Opinion Nos. 468 and 546. In addition, the Commission cites certain dicta in Justice Clark's majority opinion in *FPC* v. *Hunt,* 376 U.S. 515 (1964).[1]

The Commission in discussing the "small producer" problem in Opinion 468 said the following:

> While we are convinced that there is a need for distinctive treatment for small producers . . . we do not believe it is necessary or desirable to provide outright exemption. We reach this conclusion assuming that exemption is legally permissible despite the mandatory language of Sections 4 and 7 of the Natural Gas Act.[49]
>
> ---
>
> [49]Section 4(a) states in part that "*all* rates and

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[1]In *FPC* v. *Hunt, supra,* and *Wisconsin* v. *Federal Power Commission,* 373 U.S. at 329 (1963) Justice Clark suggested that the Commission look to the National Labor Relations Board for a method of handling exemptions. These exemption practices consisted of the National Labor Relations Board ceding its jurisdiction in certain cases to state or territorial agencies. Therefore, there would remain a body with jurisdiction over labor disputes if the National Board chose not to take the case. There are no similar state or territorial agencies which could regulate the "small producer" sales of natural gas for resale in interstate commerce.

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Thus, the Commission itself has expressed serious doubt that a full exemption of "small producers" would be legally permissible. In this same vein, it should be recalled that the Supreme Court in the *First Phillips* case made no reference to the size of the natural gas producers in holding that Congress intended that their sales of gas for resale in interstate commerce should be regulated by the Federal Power Commission.[2]

III

Another aspect of the proposed rule which the Commis-

charges" by "any natural gas company shall be just and resonable." In Section 4(c) it is stated that "under such rules and regulations as the Commission may prescribe, *every* natural gas company shall file .... in such form as the Commission may designate, ... *all* rates and changes ..."

Section 7(c) provides in part that "No natural gas company . . . shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity . . ." (emphasis in original)

[2]*Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. at 682. The Court said: "... we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." This same language was quoted by the Fifth Circuit in *Deep South Oil Co. of Texas* v. *Federal Power Commission*, 247 F.2d 882, 887. In that case the Court held that Deep South (described as "a small, unintegrated corporation engaged in the exploration for and the production of oil and gas") was a "natural gas company" within the meaning of the Act.

sion should consider is that upon termination of existing gas sales contracts, "small producers" apparently will be free to enter new contractual arrangements, either on a jurisdictional or a non-jurisdictional basis. In this regard, at least two serious questions are raised: (1) would a pipeline company be assured of recouping its cost in paying the "going" field price to the "small producer" in order to keep the remaining reserves? and (2) if the remaining reserves are contracted to another purchaser (jurisdictional or non-jurisdictional), would the present pipe-

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line purchaser be required to obtain abandonment authorization for his gas purchase facilities before the purchases could be terminated? See: *United Gas Pipeline Company v. Federal Power Commission*, 385 U.S. 83 (1966).

IV

Under the proposed Regulations a person would qualify as a "small producer" to the extent that he sells less than 10,000,000 Mcf annually. While it is unclear what would happen if a "small producer" exceeded the above volume, it should be anticipated that a "small producer" would consciously withhold sales, and where possible deliveries, of gas near the end of the year rather than lose his "small producer" exemptions. This withholding would occur, of course, during the cold months of November and December, when natural gas is in a period of great demand.

V

Under existing Regulations [Section 154.91(b)] the Commission recognizes that in many instances jurisdictional sales of natural gas may be made, although the purchasing pipeline has *no* contractual relationship with the producers of the natural gas. Such situations arise (1) when a plant or property operator purchases natural gas from another on a percentage-of-the-proceeds basis and resells such gas to a pipeline and (2) when a plant or property operator sells natural gas to a pipeline under a

gas sales contract which has not been signed by a co-owner of the gas producing property, *i.e.*, a "non-signatory co-owner" situation. Under present Regulations, neither a "percentage formula" seller nor a "non-signatory co-owner" may file certificate applications, rate schedules

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or rate schedule changes. However, before such sales can be terminated, the seller must secure abandonment authorization from the Commission. See: Sections 154.91(d) and 154.91(e).

In the text of the Notice, the Commission specified that the proposed exemption "would not include percentage sales made by small producers".[3] Apparently, such sales would remain subject, *inter alia*, to the abandonment provisions of the Natural Gas Act and the existing Regulations. The proposed Regulations, however, are not so clear with respect to "small producer" "non-signatory co-owner" sales, particularly in view of existing Regulations (154.91(d)) which allow a "non-signatory co-owner to take his gas in kind" and dispose of it on some other basis, provided he first obtains, *inter alia*, Commission abandonment authorization under Section 7(b) of the Natural Gas Act.

If the Commission intended that "small producers" in "non-signatory co-owner" situations should be free "to take their gas in kind", then at least two significant problems must be considered from the purchasing pipelines' point of view.

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[3]In proposed Section 157.40(a) (3) (iii), defining "small producer sales", the Commission included "sales of a small producer's interests under another producer's contract". This is apparently inconsistent with the announced intention that "percentage formula" sales by "small producers" *would not be* subject to the exemption. On the other hand, proposed Section 157.40(a) (1) would exclude volumes sold by a "small producer" under percentage contracts in determining whether the particular producer sold in excess of 10,000,000 Mcf annually.

First, it should be anticipated that small non-signatory co-owners will seek alternative dispositions for their gas, perhaps to non-jurisdictional markets. Second, if an operator for a small

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non-signatory co-owner continues to deliver gas to the existing purchaser after an exemption is granted, serious uncertainties may arise as to the pipeline's obligations to the various interest owners, particularly those that are exempted and with whom the pipeline has no direct contractual relationships.

VI

In the Notice, the Commission states the proposed exemption would not apply to "percentage sales made by small producers." It is unclear whether the Commission intended to include royalty gas within the "percentage sale" concept. In this respect the Commission held in *Denman, et al.*, Opinion No. 562, 42 FPC 164 at 174, that the royalty payment provisions in a lease from which a jurisdictional sale was made constituted "a sale for resale of natural gas in interstate commerce subject to regulation under the Natural Gas Act".

VII

There are potential accounting and billing problems arising out of this proposed rule. Tennessee is largely dependent upon the operator's invoice for any breakdown of the total volume received at a delivery point which involves a commingled gas stream. Classification of volumes of gas would have to be set out on invoices by rate schedules and "small producers" volumes (shown by each small producer and not in the aggregate) in cases where the operator is billing for both large producer gas and "small producer" gas. As a minimum, verification of "small producer" volumes by the operator should be required by the Commission.

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There are also problems concerning the status of a producer. On page 3 of the Notice, the Commission states that:

> "producers who have received small producer certificates under the present provision of Section 157.40 or who have applied and qualify but have not yet received such a certificate would not be required to file new applications unless otherwise directed in any order issued herein."

A pipeline may not have been served with these producer applications and thus may be unaware that they qualify as "small producer". "Small producers" should, therefore, be required to show a certificate or other proof of their "exempt" status when selling gas to the pipeline company.

VIII

The present Regulations recognize that frequently one producer will assign to another producer all or part of an interest in a gas producing property which is covered by an effective gas sales rate schedule. See Sections 154.92(d)(1)(2)(3), and 157.24 of the Regulations. Generally speaking, these Regulations provide for filings by the assignee for authorization to continue a sale and to provide for any refund obligations which may be imposed with respect to gas deliveries either before or after the assignment. Under the Commission's proposal "small producers", as assignees of gas producing properties from "large producers", apparently would not be required to make the filings required by the present Regulations. As a result, the pipeline purchaser could be exposed to considerable uncertainty as to its obligations with

respect to dedicated acreage and/or reserves subject to a contract and rate schedule, particularly

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in situations where only a partial assignment of interest is made by a "large producer" to a "small producer". See: *Skelly Oil Co.,* 35 FPC 849 at 856; *Turnbull and Zoch Drilling Co.,* 36 FPC 164 at 166.

IX

In the Notice, the Commission states in the first paragraph that it proposes to *prospectively* exempt from regulation all existing and all future jurisdictional sales made by "small producers". However, proposed Section 157.40(b)(1) provides that "small producers may apply for exemptions to cover all *previous* and all future jurisdiction sales . . ." The use of the word "previous" seemingly is inconsistent with the earlier use of the word "prospectively". In order to avoid any possibility that the proposed exemptions would apply retroactively, it is suggested that the word "previous" be changed to "existing".

X

In the event it is determined that a conference is necessary, we respectfully request notification thereof. Correspondence with respect to the Commission's proposals in Docket No. R-393 should be addressed to each of the persons shown below.

Respectfully submitted,

TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC.

By /s/ Michael W. Moore
MICHAEL W. MOORE
ATTORNEY

Harry S. Welch
Phillip D. Endom
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Houston, Texas 77001

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers	)	
From Regulation	)	Docket No. R-393
	)	

COMMENTS OF GLOVER HEFNER KENNEDY
OIL COMPANY UPON PROPOSED RULEMAKING

Glover Hefner Kennedy Oil Company (GHK), pursuant to the Commission's Notice issued July 23, 1970 in the captioned docket, hereby submits its comments upon the proposed rulemaking in such docket. In support hereof, GHK states as follows:

I.

GHK is a partnership with its principal place of business at 1010 Kermac Building, Oklahoma City, Oklahoma 73102. Communications or correspondence relating to these comments should be addressed to:

Robert A. Hefner, III
Managing Partner
Glover Hefner Kennedy Oil Company
1010 Kermac Building
Oklahoma City, Oklahoma 73102

II.

GHK is a small producer,[1] with extensive natural gas lease

[1] According to the criterion specified in the proposed rule and in §157.40 of the Commission's Regulations, viz. total jurisdictional sales not in excess of 10,000,000 Mcf annually.

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exploration and development operations concentrated almost exclusively in the Anadarko Basin of Oklahoma and Texas, and at depths therein below 15,000 feet.

GHK was created in the late 1950's for the express purpose of exploring for and developing natural gas reserves in the deep protion of the Anadarko Basin. GHK's operations accordingly are gas-oriented, and necessarily are carried out by a staff highly specialized and expert in the fields of deep gas technology and exploration.

GHK began exploration in the deep Anadarko Basin in 1959, and has expended over $25 million in partially developing leases acquired upon approximately 250,000 acres, including $5 million for geophysical data. The vast amount of geophysical, geological and other information accumulated by GHK convinced it that the deep Anadarko contains untapped reserves in the range of 50 to 100 trillion cubic feet. GHK also was aware of the high cost of drilling to depths of 20,000 to 25,000 feet, but believed that the magnitude of anticipated reserves discoveries could justify such costs, assuming, of course, that sufficient compensation could be obtained from gas sales to cover costs, and return funds for further development operations. Accordingly, upon completion of its initial well in the deep Anadarko, the Green 1-1 Well in Beckham County, Oklahoma, at a depth of 24,452 feet, and at costs in excess of $4.5 million, GHK executed a gas sales contract at an initial rate of 21.0 cents per Mcf. Although GHK knew

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that the so-called guideline price in the area was 15.0 cents per Mcf, GHK believed that it could derive some price relief, albeit prospectively, after a short time through expeditious Commission action upon its certificate application, filed in early February, 1970, proposed rate increase after certification, and possibly in the Hugoton-Anadarko Area Rate Proceding, Docket

No. AR64-1, *et al.* However, delays ensued. A certificate was issued in late May, almost four months after filing, at a conditioned initial rate of 15.0 cents per Mcf;[2] and GHK's proposed rate increase filed in late May, was placed under suspension expiring in late November. Thus, for approximately 10 months, absent action in Docket No. AR64-1 compelling a different result, GHK will have been deprived of almost 29 per cent of its annual contract revenue, or approximately $84,000 with the prospect thereafter of having to make refunds of amounts collected above the "just and reasonable" rate. It is obvious that these funds, which could have been reinvested in further-development of GHK's properties, were irretrievably lost as a direct result of statutory and administrative delays attributable to Commission regulation. This example

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should make quite clear the inhibiting effect upon a small producer's exploration and development program which regulation under the Natural Gas Act, and particularly artificial, unreasonably low "guideline" prices, has had. GHK believes that such regulation could very well squelch otherwise aggressive and innovative E & D programs by it and other small producers.

III

GHK thus strongly supports the small producer exemption proposed in this docket.[3] While adoption of the rule cannot

[2]This 15.0 cents rate applies also to sales of gas from much shallower, lower-cost Oklahoma wells. There thus is no incentive for deep exploration where gas produced from a well completed at a cost of $4.5 million, as here, receives the same initial price as a shallow well costing $100,000.

[3]GHK supports as well any proposal to exempt from regulation under the Natural Gas Act all entities, including major producers, which make sales of natural gas in interstate commerce for resale, and which reinvest revenues derived from such sales in exploration for, and development of natural gas reserves.

erase past revenue losses and consequent declining rates of exploration, the proposed exemption is in the public interest for the following reasons:

A. Prescription by the Commission of the prices which the small producer could realize for his gas has had effects well beyond restricting return on investment. Such price regulation, appreciably and adversely has affected the small producer's principal source of funds with which to finance the search for gas and development of reserves once discovered, *viz.* firm revenues from current sales. In this regard, small producers, have been at a comparative disadvantage in raising

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funds for such purposes. A gas-oriented small producer such as GHK, in contrast to most major producers, does not have other operations, *e.g.* petroleum refining, to subsidize natural gas E & D activities. Similarly, sources of debt capital available to large integrated companies may not be readily tapped by small producers. Further, as a direct consequence of regulation, prices for gas sold by small producers have been neither adequate, nor even firm in many cases, thus, leaving small producers without any dependable source of capital for funding exploration and development.

In the present nationwide gas supply shortage situation, which by all indicators in the absence of corrective regulatory steps may last for an appreciable time, the proposed exemption would have the effect of permitting gas to be sold by small producers at generally higher contract prices, and thus would foster rejuvenation of E & D programs by small producers such as GHK. This result should follow naturally from the mere absence of the applicability to small producers of the artificially low guideline prices governing producers' initial sales prices which prescribed ten years ago and unrevised today to reflect current conditions, have proved an impediment to intensive

exploration and development, the best evidence of which is the supply shortage itself.

It is particularly crucial for the Commission to encourage the revitalization of E & D programs by small producers

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in the deep Anadako Basin because of the sheer immensity of untapped reserves in that province, because small producers are the vanguard of deep drilling efforts, and because the province is traversed by 15 interstate pipelines, all of which means that successful development of the area would *significantly* contribute toward alleviation of the gas shortage. Adoption of the proposed exemption by allowing effectuation of small producers' contract prices, would reinstitute the viability of the small producers' principal source E & D capital–revenues from current sales–and this in turn would provide a definite incentive for needed revitalized E & D activities.

B. Without doubt, implementation of the proposed rule would also have the effect, beneficial to the consumer of "jurisdictional" gas, of allowing interstate pipeline companies to complete effectively with intrastate purchasers for small producers' natural gas reserves, large blocks of which have in recent years been diverted to the intrastate markets because of higher prices which such producers received from intrastate buyers.

West Texas provides the best documented example of this fact. A producer of "new" gas from the Permian Basin must accept a discount averaging 23% and going as high as 31% to make sales to the jurisdictional market. Top price for gas in the jurisdictional

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market is 16.5 cents for new gas, while purchasers in the

intrastate market have paid up to 23.99 cents. If the jurisdictional market had been competitive during 1968 and 1969, some part of the 130 billion cubic feet of new annual production going to the intrastate market during those years could have been sold in interstate commerce. Under the exemption proposed, at least in the near term, small producers' wellhead (contract) prices for such reserves will tend to rise. However, even at wellhead rates up to 30-35 cents per Mcf, the ultimate consumer still should be paying prices less than, or approximately the same as those now paid for Canadian natural gas or foreign LNG, both of which have been used increasingly by distributors to supplement declining domestic natural gas supplies. Such being the case, it is more in the interests of the United States and gas consumers for the Commission to stimulate domestic production rather than subsidize foreign production. By allowing small producers to sell gas at contract prices, an effect of exemption from price regulation, the proposed rule would so serve national interests.

C. As the Commission is aware, a serious problem encountered by small producers, caused by the mere fact of regulation, is the irretrievable loss of cash flow resulting from shut-in wells awaiting certificate authorization. Facts stated above as to GHK's own

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situation illustrate the problem. That the problem is representative among small producers was recognized by the Commission in its opinion in the *Permian Basin Area Rate Proceeding*, 34 FPC 159, 235 (1965):

> "We recognize the burdens to small producers of complying with the filing requirements promulgated pursuant to Section 7 of the Natural Gas Act before new gas supplies can be connected. Such filings, which

are routinely handled by the larger companies can, in the case of a small producer, strain his resources. The time lag, even the few weeks required under our expedited procedures, can deprive a small producer of badly needed income."

Effectuation of the small producer exemption would eliminate such losses caused by delays inherent in regulation, as well as free the Commission's administrative resources for expeditious and thorough attention to matters involving large producers and others, and thus is in the public interest.

IV

As part of the small producer exemption, the Commission should relieve small producers of their potential refund obligations under temporary certificates and Section 4(e) proceedings. To enforce such contingent liabilities would be contrary to the basic purposes of the exemption and would offset its beneficial effects, *viz*, emancipation of funds for E & D.

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Alternatively, however, the Commission could lift such refund obligations upon the condition that refund monies be employed for exploration and development of reserves. Refunds would not thus technically be "forgiven," but merely alternatively channelled. In such a manner, the Commission could be assured directly that such funds would be used for the benefit of ultimate consumers by potentially increasing gas supplies.

V

GHK does not request a conference to discuss the proposed exemption, but desires to be informed of any conference scheduled to be convened by the Commission so that its repre-

sentative may attend.

WHEREFORE, for the foregoing reasons, GHK urges the Commission (1) to adopt the amendments to its Regulations as proposed in its Notice of July 23, 1970 in this docket, and (2) to adopt additional amendments relieving small producers from refund obligations under temporary certificates and rate proceedings, or alternatively to provide that refund amounts under such contingent

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obligations may be employed for exploration and development of natural gas reserves, in lieu of refunds to purchasers, provided that sufficient assurance is given to the Commission that such amounts will be so employed.

Respectfully submitted,

GLOVER HEFNER KENNEDY OIL COMPANY

September 14, 1970.

By: s/s Robert A. Hefner, III

Robert A. Hefner, III
Managing Partner

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

Exemption of Small producers) From Regulation)	Docket No. R-393

COMMENTS AND RECOMMENDATIONS OF CONSOLIDATED GAS SUPPLY CORPORATION

Consolidated Gas Supply Corporation (Consolidated Supply) hereby submits its comments and recommendations in response to the Commission's Notice of Proposed Rulemaking, issued July 23, 1970, in the above-entitled matter.

Consolidated Supply is an operating subsidiary of Consolidated Natural Gas Company, a registered public utility holding company, and is a natural gas company within the meaning of the Natural Gas Act, subject to the Commission's jurisdiction thereunder. Consolidated Supply and its affiliates comprise the Consolidated Natural Gas System, which serves market areas in New York, Ohio, Pennsylvania and West Virginia. Consolidated Supply, which is the principal supply arm of the Consolidated System, depends for a relatively small but nonetheless substantial and critically important portion of its gas supplies upon contracts with small producers as defined in the proposed regulations, particularly in the Appalachian Area. Consequently, Consolidated Supply has a vital interest in the subject matter of the rule-making proposed in this Docket.

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Small Producer Exemption Proposed Needs Modification

The proposed regulation would exempt small producers with respect to their small producer sales of natural gas in inter-

state commerce under the Natural Gas Act, apparently including (1) certificate regulation under Section 7(c) and (e); (2) rate regulation under Sections 4 and 5; and (3) abandonment regulation under Section 7(b). The regulation proposed would prescribe the forms of application for exemption and annual statements to be filed by producers holding small producer exemptions.

The proposed regulation should, for the reasons stated below, be modified as follows:

(A) Small producers should be exempt from certificate and rate regulation only to the extent that their small producer sales are made at rates not in excess of applicable ceiling guideline rates or just and reasonable area rates, if the latter have been determined for the area, subject to a provision for petitioning for amendment or waiver permitting higher prices, as suggested in the Commission's Notice of Proposed Rulemaking issued October 16, 1969, in Docket No. R-371;

(B) Small producers should be exempt from compliance with Section 7(b) of the Natural Gas Act with respect to the abandonment of their small producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment; and,

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(C) Annual statements by small producers should be expanded to show, in addition to the volumes of annual sales as proposed in Attachment B to the Commission's Notice herein, by areas and jurisdictional purchasers the volumes sold and the prices charged (including what part, if any, constituted production or severance tax reimbursement).

The indicated purpose and effect of the proposed exemption would be to relieve small producers of the many expenses

and burdens of complying with Commission regulatory requirements, and it would also relieve the Commission, its Staff and the jurisdictional purchasers of many of these burdens and expenses. Considering the great number and usually routine nature of the filings now being made by small producers and the relatively small amounts of gas involved with respect to each such filing, the purpose of the proposed regulation is highly salutary and should be achieved.

The proposed regulation goes further than is necessary to achieve the commendable purpose referred to and conceivably could prove to be unnecessarily expensive to gas consumers, in view of the nation's current critical gas supply situation. The Commission's Notice herein suggests that the impact of exempting small producers from regulation should be minimal because they account for a relatively small share of the natural gas produced nationally, and, as a practical matter, small producers are normally not in a position to obtain more for their sales than the large producers whose sales are subject to FPC ceilings in each area. Although this may be true for the country in large part, it is doubtful that

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such assumed economic and competitive restrictions prevail, at this time, in the Appalachian Area. As the Commission has pointed out in its Notice Of Proposed Rulemaking in Docket No. R-371, a preponderance of nonpipeline-produced gas in the Appalachian Area is produced by small producers, and the vast majority of sales in that area is made by small producers. In normal circumstances—with ample supplies available—the alternate cost of purchasing Southwest gas at delivery points in the Appalachian Area could act as an effective upper limit for prices for gas produced in that area. This alternative, and its restraining effect upon prices, does not now exist because gas to meet the increased market requirements in the Northeast is simply not available from the pipeline companies serving that

area from the Southwest. Since neither the prices obtainable by the few major independent producers in the Appalachian Area nor the rates at which new supplies of gas are *not now available* from the long pipelines serving that area set any kind of effective economic limit to the rates obtainable by the small producers, the continued imposition of ceiling prices by the Commission upon small producer prices in the Appalachian Area, or any other areas of the nation which are vitally dependent upon local small producer sales, is essential if the consumer is to be protected against imposition of increased prices greater than those necessary to elicit additional supplies.

In areas of the nation where small producer sales are in the minority, and thus where small producers cannot obtain contracts for prices higher than those obtained by the regulated major producers,

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imposition of a requirement that small producers must file with your Commission for authorization to make sales in excess of ceiling rates would impose no burden.

Certainly, the existing applicable producer rate ceilings in the Appalachian Area are too low to provide necessary additional supplies, and Consolidated Supply has urged and will continue to urge that they be raised promptly and substantially in both Docket Nos. R-371 and R-389A.

With respect to abandonment authorizations for small producers, the vast majority of these are routine matters occurring because of depletion of production or circumstances which have made continuance of the sale to the pipeline purchaser uneconomical. The pipeline purchasers in these situations routinely consent to the abandonment of the sale, and Consolidated Supply sees no necessity under the Natural Gas Act for the Commission to be involved with the processing of these routine and uncontroverted abandonments. Only in the rare

situation in which there might be a dispute as to whether a small producer sale should be discontinued should there be some procedure whereby a Commission determination can be had as to whether the abandonment is permitted by the present or future public convenience or necessity.

The additional data suggested for inclusion in the annual statement form to be filed by producers holding small producer exemptions would impose very little, if any, burden and, at the same time, would provide information that would be useful to both the Commission and the public.

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Waiver Of Commission Regulations To Permit Tracking Of Rate Increases Resulting From Exemption Of Small Producers

The Notice herein also states that the Commission proposes to waive the provisions of Section 154.63 of the Regulations solely to permit the tracking of the rate increases resulting from the exemption of small producers, provided that (1) where present orders governing tracking by the pipeline purchasers are not involved, the supporting schedules required by Section 154.63 shall be filed within four months, and (2) the rates as revised by such tracking shall be subject to reduction and refund from their effective date. Apparently this is an announcement of a policy which the Commission proposes to adopt, but it is not proposed that this policy be embodied or the mechanics of its application set forth in the proposed regulations.

It should be noted that, if the Commission's proposal to exempt small producers from rate regulation be modified as suggested by Consolidated Supply herein to permit such exemption only where the rates charged are not in excess of applicable ceiling rates, then questions concerning the tracking of increased costs resulting from the exemption of small producers should be moot.

However, assuming that the Commission exempts small producers from rate regulation without the qualifications suggested by Consolidated Supply, it seems likely that rate increases resulting from the exemption of small producers will form only a small part of the increases in cost of gas which pipeline purchasers and pipelines purchasing from such pipeline purchasers are virtually required

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to track under the Commission's decision in Texas Eastern Transmission Corporation.[1] Further, pipelines purchasing from pipeline purchasers are also confronted with the necessity of tracking general rate increases, including but not limited to producers' price increases, filed by the pipeline purchasers. It would appear to be administratively chaotic both for the Commission and for the pipelines if one set of rules is to be applied to the tracking of that portion of supplier cost increases which is due to rate increases caused by exemption of small producers, and another set of rules is to be applied with respect to the rest of the jurisdictional increased supplier costs which pipelines must track.

For these reasons, Consolidated Supply urges that this is not an appropriate proceeding in which to determine rules, conditions and procedures for the tracking of rate increases resulting from the exemption of small producers. If the Commission believes it appropriate to establish rules concerning tracking of supplier cost changes in a rulemaking proceeding, rather than considering the problems of each pipeline company on an *ad hoc* basis, then Consolidated Supply urges that a separate proceeding be instituted to consider procedures for tracking the net effect of all changes in gas supply costs which must be tracked. The attention and the comments of the industry and others affected could then be focused

[1] *Texas Eastern Transmission Corporation*, 39 FPC 630 (1968), rehearing denied 40 FPC 62, affirmed, *Texas Eastern Transmission Corp. v. FPC*, 414 F.2d 344 (5th Cir. 1969), cert. denied ____ U.S. ____, 26 L.Ed.2d 89 (1970).

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on tracking problems in a proceeding concerned primarily with that subject rather than in this proceeding, in which only a minor portion of the tracking problems are involved incidentally.

If, however, small producers are to be permitted to charge higher rates than large producers, and the problems of tracking resultant cost increases are to be considered in this proceeding, then Consolidated Supply takes serious exception to the proposed policy as announced in the Commission's Notice herein.

First, in the Appalachian Area and other areas where escalation clauses in producer contracts are not common, the increased cost effect from exempting small producers will not lie primarily in rate increases, which is all that it is proposed in the Notice to permit pipeline purchasers to track; rather, the substantial cost effect will result from the replacement of continually-diminishing supplies under existing contracts with new contracts covering new supplies at higher, unregulated prices. It is the increase in the average cost of gas which needs to be tracked in some fashion, rather than price increases only.

Second, schedules and such supporting data as may be required to support tracking increase calculations can and should be furnished very promptly, in much less than four months. These are relatively simple and minor compared to the schedules required by Section 154.63, even if limited to Statements L through N. The latter require compilation of voluminous data, most of which have nothing to do with a tracking increase and should not be required.

Third, as to the requirement that the rates as revised by the tracking filings shall be subject to reduction and refund, it may

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first be noted that this requirement does not state that only the increased portion of the revised rates shall be thus conditioned.

Rather, the Notice seems to say that once a pipeline tracks a rate increase imposed on it by the Commission by exemption of small producers, the pipeline's entire revenues become subject to refund retroactively to the date of the increased rates. The unfairness of this proposal, even if limited to the increased portion of the revised rates, need not be belabored here, particularly in view of the fact that the small producer increases to be tracked would be firm rate increases under the Commission's proposed policy.

Communications in regard to this proceeding should be addressed, in addition to the undersigned, to Henry P. Sullivan, General Counsel, Consolidated Natural Gas Company, 4 Gateway Center, Pittsburgh, Pennsylvania 15222, and David E. Weatherwax, General Counsel, Consolidated Gas Supply Corporation, 445 West Main Street, Clarksburg, West Virginia 26301.

Consolidated Supply does not request a conference to discuss the proposals involved herein; however, it does desire to participate if a conference is convened by the Commission in this proceeding.

Respectfully submitted,

CONSOLIDATED GAS SUPPLY
CORPORATION

By /s/ Norman A. Flaningam
NORMAN A. FLANINGAM
Its Attorney

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FEDERAL POWER COMMISSION

In the Matter of:

Docket No. R-393

Exemptions of Small Producers
from Regulation

GAO Building,
Room 2043,
Washington, D.C.
Tuesday, December 8, 1970

A conference on the above-entitled matter was convened at 10:00 o'clock, a.m., pursuant to notice.

PRESENT:

FRANCIS J. GILMORE (Presiding)
JOHN F. JOSEPH, Federal Power Commission Staff
RICHARD F. GENERELLY, Callery Properties, Inc., and Eason Oil Company
S. BLICKMAN, FPC-OEC
JAMES McCARRICK, FPC-ARD
W. B. MAXWELL, Colonial Gas
C. G. KREBS, Krebs Oil Company
R. H. ADKINS, MDP Producer
JAMES P. McKINNEY, Jr., Signal Oil and Gas Company
MICHAEL P. KELLY, Signal Oil and Gas Company
ROBERT J. HAGGERTY, Atlantic-Richfield
E. B. CURRY, Sweetland Land and Min. Co.
T. D. KAUFFELT, Attorney for Sweetland Land and Min. Company

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PRESENT (Continued)

EDWARD H. FORGOTSON, Attorney for J. M. Forgotson
ROBERT O. KOCH, Texas Gas Transmission Corporation
CHRISTOPHER T. BOLAND, Tes Gas Transmission Corp.
CHARLES V. SHANNON, Michigan Wisconsin Pipeline Company
M. W. MOORE, Tennessee Gas Pipeline Company
PHILLIP D. ENDOM, Tennessee Gas Pipeline Company
JAMES A. MASTERSON, Prenalte Corporation
WAYNE OGDEN, Tennessee Gas Pipeline Company
JAMES R. McCOTTER, Northern Pump Company
PHILIP R. EHRENKRANZ, Glover Hefner Kennedy Oil Company, Inexco Oil Company, Ladd Petroleum Company, Woods Petroleum Company
HARRY B. SHEFTEL, OMB
TOM C. McCORKLE Pan American Petroleum Corporation
JOHN L. WILLIFORD, Phillips Petroleum Company
KENNETH HEADY, Phillips Petroleum Company
ROBERT W. HENDERSON, Hunt Oil Company, et al
DAVID R. FRICK, Northern Illinois Gas Company
PHILIP S. PAUL, Southern California Gas Company

E. A. STANSFIELD, Western Slope Gas Company (Intrastate Company), Room 990 550-15th St., Denver, Colorado 80202
RAY W. RICHARDS, Panhandle Prod. Company
EDWIN S. NAIL, Amerada Hess Corporation
NORMAN A. FLANINGAM, Consolidated Gas Supply Corp.
RICHARD B. GORDON, Consolidated Gas Supply Corp.

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PRESENT (Continued)

J. F. KEARNEY, Commonwealth Gas Corporation
REX D. FOWLER, Northern Natural Gas Company
WILLIAM I. POWELL, IPAA
JOHN E. WATSON, Tenneco Oil Company
JOHN P. FURMAN, Kansas-Nebraska Natural Gas Company
GEORGE E. BONNER, New York PSC
RICHARD A. SOLOMON, New York PSC
THOMAS F. JOYCE, Federal Power Commission Staff
EDWARD M. McMANUS, Federal Power Commission Staff
JOHN M. DONNELL, Federal Power Commission Staff
B. JAMES McGRAW, Gulf Oil Corporation
V. E. BOYER, Continental Oil
DAN BRUCE, Shell Oil Company
J. H. MORTON, Shell Oil Company
SAIDA SHAALAN, NERA
WILLIAM T. HARKOWAY, Consolidated Edison Company of New York

R. J. LEITHEAD, Cities Service Oil Company
FREDERICK MORING, AGD
JOHNATHAN E. GAINES (Donovan, Leisure, Newton & Irvine), the Pittson Company
KIRK W. WEINERT, Texaco Incorporated
TOM P. HAMILL, Mobil Oil Corporation

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PROCEEDINGS

MR. GILMORE: My name is Frank Gilmore. I am a lawyer on the staff of the Federal Power Commission. I will preside today at this conference concerning the rule making proceeding in R-393, the exemption of small producers from regulation, as proposed in a notice issued July 23, 1970.

This conference will be recorded; and if any of you want transcripts, you can arrange with the transcriber to get them.

I do not propose today to take any position with respect to various matters discussed here. This conference is essentially an opportunity for those of you who wish to make any further comments concerning the various matters which have been discussed this far in this proceeding.

I will pass an attendance sheet around, and it will be transcribed in the record after I get it in return.

For the benefit of the Reporter as well as the others in this room, when you stand up to speak, would you please state your name before you start making comments.

As to the format, there is no format set forth in the notice of this conference issued on November 18. I am open to suggestions as to how you would like to handle this conference. I would suggest that we discuss seriatim some of the issues involved here, but because of the large number of potential issues, I have just picked out three of the more important

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issues for seriatim discussion. Then I would suggest that anybody who wishes to make further comments simply make

them under a miscellaneous heading.

MR. ENDOM: I am representing Tennessee. If you do not comment, that does not constitute any sort of waiver of any rights or anything like that?

MR. GILMORE: No.

MR. ENDOM: Thank you.

MR. GILMORE: Is there anybody here who has not filed written comments who proposes to participate actively in the discussion here?

MR. KAUFFELT: I have filed no written comment.

MR. WATSON: My name is John Watson, and I am with Tenneco Oil. I did not file any comment, and I can't say whether I will participate. I don't have any plans to participate actively. I am here as an observer primarily.

MR. GILMORE: Let me suggest that if either one of you do, that you also file written comments, and that whatever you say here will be accepted subject to the Commission approving, let's say, your late entry with respect to the written comments.

The three issues that I wanted to take up seriatim were: first, the legality and feasibility of the proposed exemption.

Secondly, the exemption of a sale by one producer

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to another producer for resale to a pipeline. And the third matter is the extension of the exemption to present certificate and rate proceedings and the refund obligations relating thereto.

MR. BOLAND: Repeat the last one.

MR. GILMORE: Extension of the exemption to present certificate and rate proceedings and the refund obligations relating thereto.

MR. McKINNEY: I don't know whether this comes under legality or feasibility, but before getting into any of these questions, I would like to ask one question, at least to clarify the notice of proposed rule making issued by the Commission.

At the outset, in the first paragraph of the rule making, the Commission indicates that, "this would not include percentage sales made by small producers pursuant to percentage sales contracts."

I took it from reading that sentence that the exemption simply would not extend to present small producer sales under percentage sales contracts. Then I got back over into the ordering clauses, and although I suppose that those ordering clauses can be interpreted as excluding percentage sales by small producers, nonetheless it is not clear at all to me,

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and it seems to me that at the very least if that is what the Commission intended, there ought to be an expressed ruling out or exemption of that kind of sale from this rule making. But to me the introductory paragraph of the Commission's notice is contradictory to what is contained in the order itself.

I was wondering if the staff could comment on that as to what the notice of proposed rule making actually anticipates in that regard.

MR. GILMORE: I think it anticipates exactly what you indicated, that the small producer exemption would not apply to percentage sales contracts.

MR. ENDOM: Does the staff have a position with respect to statutory basis of this proposal?

MR. GILMORE: Wait just one second.

MR. McKINNEY: I have just one more question.

I take it then if it does not apply, that the present Commission regulations would require the seeking of abandonment authority by producers who are selling under

percentage contracts would still be equally applicable to those producers?

MR. GILMORE: That is correct.

MR. ENDOM: Excuse me. I believe you said earlier that the staff was not going to take a position in certain areas, but does the staff have a legal position with respect to the statutory basis for the proposed exemption?

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MR. GILMORE: No. I don't propose to take any position here.

MR. ENDOM: Well, it was said on the other question that percentage type sales would continue to be regulated, as I understand it?

MR. GILMORE: Under the proposed rule as noticed on July 23, 1970.

MR. ENDOM: That was one type of sale that Tennessee was concerned about.

The other type was the type of purchase where it is not a percentage sale, it is just a sale made under metal producers rate schedule in a non-signatory co-owner type of situation. The proposed rule did not actually address itself to that particular matter, but I was wondering what the staff's position is on that.

MR. GILMORE: I believe the non-signatory co-owner who was a small producer would be exempt under these provisions.

MR. FORGOTSON: You mentioned, concerning percentage sales to be regulated, in order for them to be deregulated, they would have to get abandonment permit first, is that right?

MR. GILMORE: They simply wouldn't be deregulated or exempted under the proposal in R-393, and the abandonment requirement would be the requirement which exists at the present time, and has existed for some time.

MR. KAUFFELT: Is there any question regarding the

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fact that a small producer is still defined as one producing ten million or less?

MR. GILMORE: Well, in the notice of proposed rule making, that is what the Commission proposed. Now, there have been, as you may know, various comments filed by parties suggesting alternatives to that.

MR. FORGOTSON: I would like to ask one more question about the percentage sales again.

If we are representing the trust department of a bank that holds a lot of royalties, and they are all taking a percentage of the net production of the person with the working interest–in order for them to be spearate–in most cases from the groups that would be non-exempt under this regulation, they would still be non-exempt, is that right, unless they on the basis of an individual well got into a Section 7 proceeding?

MR. GILMORE: I think you are discussing a problem which is substantially different than the problem Mr. McKinney brought up.

MR. FORGOTSON: That is what I thought it was.

MR. GILMORE: I wouldn't want to get it tied in. Mr. McKinney, as I understood him, was simply talking about a situation where a producer sells to a processing plant, or that is the most usual situation, and he gets a percentage of the resale price.

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MR. FORGOTSON: Okay, fine. Are we going to deal with the royalty owner in that other question?

MR. GILMORE: If you want to.

MR. FORGOTSON: I would like to know, because that is of critical importance when a person who has got a

non-operating interest and might decide they would like to take in kind, or would just take part of the sale, would they come in as percentage, would they be non-exempt because of this percentage sales non-exemption?

MR. GILMORE: I think the royalty problem, which you have posed, will have to be clarified if and when the Commission takes any action in this rule making proceeding.

MR. McCORKLE: Is it intended to exempt the royalty interest?

MR. GILMORE: I don't think it is clearly set forth in the notice how the royalty matters will be disposed of.

MR. FORGOTSON: The same would hold for small working interests, I take it, too.

MR. SOLOMON: Maybe you were saying this before I came in. On percentage sales they are excluded, irrespective of the size of the producer?

MR. GILMORE: They would not be included within any exemption granted to a small producer.

MR. SOLOMON: Rule making under percentage sales, 10 mcf, would fall under normal percentage sale?

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MR. GILMORE: That is right.

MR. ENDOM: Would a small producer at the expiration of his contract, would he have the obligation to make any filings with the Commission under the proposed rule?

MR. GILMORE: No.

MR. ENDOM: Would the pipeline?

MR. GILMORE: I think the pipeline's obligations would be not affected by this proposed rule as now proposed.

MR. HEADY: Would the volume of percentage sales be included in the total to be determined as to whether the small

producer still qualifies?

MR. GILMORE: I am going to have to check with Mr. McManus in the back of the room.

MR. McMANUS: Repeat the question.

MR. HEADY: Would the volume of percentage sales, which under this proposal would not be exempted, would that volume be included in determining whether a small producer had exceeded the total of 10 million mcf?

MR. McMANUS: Yes, it would.

MR. HEADY: I didn't understand a moment ago the answer to the question as to what happens when a percentage sale contract expires by its own terms. Does the seller under that percentage sales contract, if he otherwise qualifies, then become exempt upon the expiration of that percentage sales contract as to that sale?

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MR. SOLOMON: If he has a certificate or if he does not?

MR. HEADY: Under normal circumstances, the seller under a percentage sales contract would not have a certificate, can't get one.

MR. SOLOMON: But under this proposal, he would have to get a certificate, isn't that what the proposal calls for?

MR. HEADY: My question is related to the point–

MR. SOLOMON: I am just asking you.

MR. HEADY: I don't know. I am asking Mr. Gilmore.

MR. GILMORE: I indicated earlier that for a percentage sale, a producer, whether large or small, would still be required under the regulations to obtain abandonment authorization.

In other words, this rule making proposal wouldn't change anything in that regard.

MR. HEADY: Can a producer who is selling under a percentage contract obtain a certificate of exemption if his total sales do not otherwise exceed the ten million if he is in fact selling both under percentage sales and other type sales?

MR. GILMORE: A small producer can receive for his sales other than percentage sales.

MR. HEADY: If a producer has such a certificate at the time the percentage sales contract expires, does that

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sale then automatically come under his certificate of exemption as a small producer?

MR. GILMORE: I don't think so. Does anyone wish to discuss the problems involved in the sale by one producer to another?

MR. ENDOM: You raised a question of feasibility, and there is certainly a heck of a lot of billing problems which we would have, if some producers were selling at one price and we didn't have a contract with them, say a large producer was selling gas, and a small producer was selling gas under his rate schedule. His rate schedule apparently would not govern that small producer volume, and there is no contract between the pipeline and small producer in a non-signatory co-owner situation, there would be extreme difficulties as far as billing is concerned.

I guess that is just a comment. I can have our senior gas representative, gas contract representative, say a little bit more about that.

MR. GILMORE: If you wish, or if he wishes, you are perfectly free to do so.

MR. ENDOM: This is Mr. Ogden, and he is with Tennessee's Gas Contract Section.

MR. OGDEN: We basically see problems resulting from the physical accounting for the gas if these small producers are released.

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Presently our accounting system is set up whereby a single operator or multiple operators in a large field would handle the accounting with comingled gas coming in through our system. When you release the small operators which will be co-producers or signator to the contract, and many of them operating behind a rate schedule of the operator, which are non-signatory parties to the contract, and then they are free to file or go to the area price in situations where the operator has a rate settlement in effect, we see compounding of price structures and an accounting on an individual basis, which will considerably increase the problems of just keeping up with the gas when it still continues to come through the comingled meter.

Now, the Commission requires us to file by rate schedule all of the gas that is delivered into the system, and if you look at a large contract, you may have half a dozen signator parties, and behind that the various parties may be purchasing gas under operating agreements, and these are exempted.

We are not sure as to what the legal status as to the contract would be with these parties that are non-signator to the contract. And we feel that it will be a problem that will certainly increase our billing and accounting procedures that are presently operating in a satisfactory manner.

MR. GILMORE: Are there any further comments on the feasibility of the proposal?

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MR. FRICK: This is not directed so much to the feasibility, but raises a question, and I am asking for some clarification.

First of all, my name is David Frick. I am representing Northern Illinois Gas Company.

The question I have concerns the freedom from quality adjustments and the relation to BTU adjustment also, and the question that I have is, will BTU adjustments continue to be necessary in the proposed rule, or are they no longer necessary and–

MR. GILMORE: Under the proposed rule, the small producer as to his exempt sales will be entitled to his contract rate, whatever that may be. So that if the contract provides for adjustments, then they will be aplicable. If it doesn't provide for it, they won't be applicable.

But in any event, it will not have any relationship to the–or any necessary relationship to the ceilings which may be set in the various areas, for instance, in Permian or in Southern Louisiana.

MR. SOLOMON: My name is Dick Solomon. Let me ask you: have we got any information from the major producers as to whether effectuation of this rule would create for them the same type of problem that was created for them in the royalty case?

If exempt producer has contractual obligations with

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a major producer, who is subject to regulation, are we going to get into the same problems where a formerly thought of exempt royalty owner had dealings with major producers?

MR. GILMORE: There were a number of large producers who did file comments, pretty strong comments on that subject. I suggest that they speak for themselves on the matter.

MR. BRUCE: I am Dan Bruce with Shell. Our comments included some remarks in this regard. We can anticipate instances in our operations where we will be faced with contractual obligations that will be affected by this rule, and we don't know yet just how they might be handled.

We were in hopes somebody here might have some comments to make, and some suggestions as to how these

obligations that are fixed contractually are going to be dealt with by companies who have, we now find, an interest which was formerly contractual obligations which were arrived at during each fractional interest in, say, a unit or other plant operation, valued at uniform level, now turns out that they are not.

We have obligations which are fixed by contract, which would not automatically in every instance be changed just because the value of the interest may change because of this freeing of regulation of some of the producers.

I haven't heard anybody address themselves to this. We raised a question, but we don't have the answer.

MR. McCORKLE: I am Tom McCorkle. Our suggestion

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was that if the Commission proceeds in this rule making, that it should modify the definition of the small producer so as to explicitly and expressly exclude the royalty owners. Because the probability of the royalty owner, like some one mentioned–some trust relationship with the bank, and many of these royalty owner interests are going to be able to qualify apparently for an exemption, and if this occurs, you are going to have problems that apparently the Commission in its opinion 562 sought to avoid.

MR. GILMORE: Would your recommendation also exclude the exempt status with respect to royalties relating to small producer sales? Let's say the small producer sale itself is exempt. What about the royalties relating to that?

MR. McCORKLE: I think, as a matter of principle, if your definition of small producers exclude royalty interests on us, that would fall in that category, then it would exclude all of them by definition.

MR. FORGOTSON: What if we have a program that qualifies his total production as being under the ten million thousand cubic feet per year and there is a royalty owner under

one of those contracts where the contract itself is exempt?

MR. GILMORE: That is the question I just posed.

MR. FORGOTSON: You weren't responsive. The question is: would they not be exempt under those circumstances?

MR. McCORKLE: The situation you are assuming is

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that the royalty owner is a fee mineral owner and gives somebody a lease, and thus, as a consequence, he remains nothing but a royalty owner?

MR. FORGOTSON: That is correct.

MR. McCORKLE: I think you will have to define your royalty owner in a different context. Your royalty owner would have to be defined as a man who was a truly non-participating royalty interest under a lease, and of course, it seems to me, that if the exemption was–in other words, if this rule making would not apply to royalty owners, if royalty owners could not claim a small producer exemption by virtue of the definition in this rule making, then they would not be excluded.

MR. FORGOTSON: Even if a person with executory interests were exempted?

MR. McCORKLE: That would be my understanding.

MR. SOLOMON: Would that not make the already discrimination problem even more discriminatory?

MR. McCORKLE: I think you are right. Certainly Opinion 562 found royalty owners were subject to Commission jurisdiction, as I understand it, and they would have a right to claim exemption unless they are excluded, am I right about this, Mr. Gilmore?

MR. SOLOMON: If they are excluded–I am raising a question–some of the larger producers have raised questions, appropriate questions as to discrimination, and I am suggesting

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that we are setting up a new discrimination question.

MR. McCORKLE: I suppose our suggestion related to the object of trying to get some incentive going to get some more gas in the interstate market.

MR. GILMORE: Coming back to the question posed a little earlier, with respect to the appropriate way to handle the sale by one producer to another, in various comments it has been suggested that either the exempt status be denied to those particular sales by one producer to another, or alternatively that the sale by the producer purchaser to a pipeline be also exempt insofar as it relates to the original producer's sales—or if they get the contract differential, which is about the same thing.

MR. BRUCE: The spread be maintained. That was a suggestion in at least three comments that came in, including ours. I did not see any that suggested that this quantity of gas be exempt in the second sale.

MR. GILMORE: No. I twisted it around slightly, but for all practical purposes it is the same thing.

MR. BRUCE: Does the staff have any comment on that suggestion? Have you thought that over?

MR. GILMORE: I am eliciting comments from others. No, I don't have any position.

MR. BRUCE: Now, we are not talking about percentage sales now, we are talking about one producer, say a plant

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operator from a small producer who will be exempt and who then has his rate, whatever that contract may be, then the producer is required to resell at the regulated rate, maybe unaccounted differential there, and our suggestion was that the spread be maintained.

MR. ENDOM: Within limits of resale contract?

MR. BRUCE: Right.

MR. GILMORE: Basically, as I understand it, to give an example of it: if Sun Oil Company sold to Shell, and the contract rate was 14 cents, and let's assume for the moment that–I picked a bad example–assume that Sun was exempt as a small producer sale, then what Shell would want for its reslae of the gas to the pipeline company is its 17 cent contract rate, relating to the gas purchase from Sun. That is the way I understand it, aside from whatever the ceilings were in the particular area involved.

MR. BRUCE: I think we have to assume a couple sets of circumstances. The first is under the resale contract, say Shell sells to Tennessee, that we have that much leeway in that contract to maintain that differential.

The second question is: suppose we don't have that in our contract, and that raises a problem to which I have not addressed myself, and I think Mr. Endom is about to.

MR. ENDOM: Come see us!

(Laughter.)

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MR. BRUCE: I think if we get over that first hurdle, then we can ask ourselves the second question, and maybe you have got the right suggestion to "come see us".

MR. HEADY: I represent Phillips Petroleum Company. For the benefit of the people here, I might state that probably somewhere between 40 and 50 percent of our total jurisdictional sales represent purchases from other producers which we purchase for processing and extraction of various products of natural gas and resale to pipelines.

That processing operation has already been determined by the Commission to be a separate nonjurisdictional business. I think it is apparent, as we have indicated in our comments, that

this proposed rule making as it is presently stated at least would have some rather drastic consequences upon that separate and independent nonjurisdictional business.

And I would like to inquire as to what rationale the Commission proposes in support of the statement that the sales by producers to another producer would be exempt under this proposal, but the resale by the purchasing producer would not?

And, secondly, why should not the resale by the purchasing producer be completely exempt in the same way that the sale to that purchasing producer is exempt?

MR. SOLOMON: Don't you have mostly percentage–

MR. HEADY: We have both.

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A VOICE: Some of them are pretty bad.

MR. GILMORE: I don't really propose to answer your question, but I would like to ask a question of my own.

Of the jurisdictional sales made by Phillips, the 40 to 50 percent you refer to, made as part of plant sales, how much of the gas which Phillips purchases is related to small producer sales?

MR. HEADY: I can't answer that question, because I don't know who would qualify as small producers, but without question it would be a very substantial part. I can't tell you in terms of quantity, because I don't know which producers would be entitled to qualify. But we do purchase substantial volumes of gas from numerous producers, that I would expect to qualify as small producers.

MR. GILMORE: Could you roughly estimate the percentage?

MR. HEADY: I wouldn't have any idea, other than to say that it is substantial. But I don't know. It seems to us that this entire proposal is slanted in such a way as to virtually drive us out of the processing business.

For example, my reason for asking the question a moment ago as to whether a percentage sale would be included in the total of ten million simply illustrates the point that why should a producer make a percentage sale to another producer, and thereby use up part of his limited exemption total

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sale.

The producer would bend over backwards not to make such a sale, because if he does that, he is making a sale which is still subject to regulation, but he is eating into the volume which he could otherwise sell completely exempt.

Our position, as we have stated in our comments, is that the proposal as it is presently stated is invalid and discriminatory on that basis, and my reason in asking what the rationale for that approach is is simply to point out that unless we know what that rationale is, we don't know what it is we are supposed to meet, we don't know what the position of the Government is, and we don't think that this proposed rule making could be valid unless that rationale is stated ahead of time, and we have an opportunity to meet it.

MR. SOLOMON: Meet it when?

MR. HEADY: At some point prior to the time that it is adopted. We don't know why the Commission is undertaking what we consider to be invidious discrimination against us.

MR. FLANINGAM: I would like to ask a question.

My name is Faningam, and I represent Consolidated Gas Supply Corporation. Since this notice was published, the Commission has issued order 411 and R-371, which did exempt producers, but did hold area rates as the ceiling.

In our comments we have suggested that that should be done. May I inquire whether or not the discussion today

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shouldn't be conducted on the premise that the Commission in order 411 has set the course and that any exemption which

might be granted will not relieve these people from observing the area rate ceilings?

MR. SOLOMON: How does that differ from small producer certificates they presently can get?

MR. FLANINGAM: I thought we ought to discuss this in light of that order, because it seems to me that indicates a policy decision, which I would assume would govern here.

MR. SOLOMON: I am not arguing with you, if you exempt the small producers from everything in the area ceiling, whatever it is, what are you exempting them from?

MR. FLANINGAM: From a lot of paper work.

MR. SOLOMON: Of course I think this makes considerable sense. I think that when you set up your system, or as you set up your system, a considerable amount can be said for expanding the small producer's procedural exemptions to the large producers as well.

I don't see any reason why our friends from Phillips should go through a lot of unnecessary paper work if they are willing to live within ceilings, anymore than smaller people.

As a matter of fact, I expect it would cost the consumers a lot more for Phillips to go through unnecessary paper work than a lot of the smaller people. As far as the

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procedure of the small producer, it would seem to me at some time, if and when you get established, that it would make a lot of sense to have consideration to expand it to all producers.

MR. FLANINGAM: If you were to do that, you would want a little more in the annual report form, would you not?

MR. SOLOMON: Maybe, but if they are willing to live within whatever ceilings are applicable, then I don't see why you couldn't allow Phillips Petroleum Company to do so with-

out filing applications, just like Joe Blow Petroleum Company.

MR. FLANINGAM: I think it makes a lot of sense.

MR. FURMAN: I am Jack Furman. I find myself more or less in agreement with these two gentlemen, because Kansas-Nebraska's position is that over 50 percent of its wellhead purchases come from producers that would be exempted by this proposal. We are very much in favor of procedural simplification and exemption. But we would be in a very uncomfortable position if the affect was to take them out from under area price ceilings.

I think that if the Commission is not going to go in the direction of complete exemption, eliminating producer regulations, that the easing of the procedural burdens on the small producers is really the main thing they ought to be striving for here.

If it is helpful, I have put together some figures

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based on 1968 data that shows Kansas-Nebraska purchases from small producers. I would be happy to offer it to the staff for inclusion in the record.

MR. GILMORE: You may certainly put it in the record. Give it to the Reporter.

(The document referred to follows:)

[T-27]

KANSAS-NEBRASKA NATURAL GAS COMPANY, INC.
Gas Purchases (Accounts 800, 801, 802, 803, 804, 805)
Year Ending December 31, 1968

PURCHASES FROM SMALL PRODUCERS

	Gas Purchases Mcf of Gas 14, 73 # psia 60°F		
	Total	From Small Producers	% of Total
TOTAL GAS PURCHASES	78,993,429		
Less Transmission Line Purchases (from interstate pipelines)	9,703,166		
	69,290,263		
WELL HEAD PURCHASES	53,853,577		
Less affiliated companies	160,988		
	53,692,589	29,129,478	54.3%
FIELD PURCHASES	10,098,734	122,622	1.2%
GASOLINE PLANT OUTLET PURCHASES	5,337,952		
Less Affiliated company	275,607		
	5,062,345	323,458	6.4%
TOTAL	68,853,668	29,575,558	43.0%

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MR. KAUFFELT: My name is Kauffelt.

Is it logical–I am asking for comments–is it logical to exempt or not exempt the area price ceiling and leave no protection for small producers as far as the perhaps unreasonable minimums or unreasonably low prices are concerned?

MR. GILMORE: If a small producer has a Sierra-type problem, then maybe the answer for him is not to seek exemption.

MR. KAUFFELT: Has anybody advocated that be changed or there will always be applications for exemption?

MR. GILMORE: I haven't even heard this problem discussed in connection with this.

MR. SOLOMON: The notice of proposed rule making talks a lot about the small producer and certificate procedure that had been in effect for the last year or so having been burdensome. I was thinking of asking the staff to explain what that burden is. I suspect you will not answer me. Therefore, I would suggest that to the extent there has been a burden on the small producers, the burden has been created by exactly the type of problem that you have just been discussing with the gentleman, i.e., interim problem of the small producers, particularly in Permian, where most of it came up, who were interested in taking advantage of the small producer certificate, at the same time while the case was on appeal, and other people could temporarily collect higher amounts on the hope that they would win the case, didn't want to be cut

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out from that. And there was an awful lot of paper work by small producers, trying to for perfectly legitimate reason, to carry the water on both shoulders while these appeals were going on. I don't know–I haven't been in this game in the last year or so–but there may be a similar problem with all the maneuvering that is going on in area prices now.

My suggestion is that these burdens that the notice talks about, the burdensomeness of the small producer's certificate, is a temporary problem rather than a permanent problem, and once the–if we ever reach that happy day when we know what

is going on in our pricing and what have you, there won't be any real burden on this small producer certificate at all.

MR. GILMORE: Of course, the question is: when do we hit this happy day?

MR. SOLOMON: Until you do, they are still going to carry the water on both shoulders, and they should. I mean, they have to protect themselves from whatever may happen in a flexible situation.

MR. GILMORE: They are simply doing the same thing that the large producers are doing.

MR. SOLOMON: I am not making any invidious statements. If I were representing a small producer, obviously I would want to get the best of both worlds and work out ways of doing it.

MR. HEADY: I am not sure Mr. Solomon and I are

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talking about the same proposed rule making, because the proposed rule making would exempt the small producers not only from filing requirements but also from rate restrictions. Mr. Solomon seems to be talking about a proposed rule making which would exempt the small producers only from filing requirements.

MR. SOLOMON: I am aware of what rule making does. I was directing myself to one of the alleged justifications for the proposed rule making.

MR. HEADY: My question is this: is it the position of the New York Commission that the exemption of small producers should be limited to the exemption from filing requirements and not exempted from rate restrictions?

MR. SOLOMON: I would think so. Tentatively I would think that is right.

MR. FLANINGAM: That was the position I stated a minute ago. I thought that in view of the Commission's Order 411 we should discuss that matter in this light.

MR. SOLOMON: What is 411?

MR. GILMORE: Appalachian.

MR. FLANINGAM: In that they did exempt small producers, but did make the area rate ceilings applicable. If you

wanted to exceed it, the small producer is required to file a petition for relief.

MR. McCORKLE: Let me ask you: if the Commission

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should include that there is serious question as to the legality and its authority to carry out what it has proposed in this rule making, for example, then wouldn't we have to fall back, in effect, to Mr. Solomon's position of what can the Commission do lawfully that would achieve your desired objective? And that is, accord as much relief as possible to the small producers, giving consideration to the exigencies of their problems as they arise in area rate making and so on?

MR. GILMORE: That is what has been suggested by Consolidated in the comments which it filed in this proceedings.

MR. McCORKLE: That is why I wanted to be sure I understood.

MR. SOLOMON: We would hope there would not be merely a determination based upon what your power is, but also what makes sense.

MR. HEADY: Let me ask what may be an embarrassing question: the Commission in its notice, it seems to me, goes both ways at the same time. On the one hand it says that the small producers probably cannot realistically expect to receive higher prices than the larger producers, yet at the same time the purpose of the exemption is to encourage further exploration by small producers.

My question, which may or may not be embarrassing, is: to what extent do the pipelines contemplate that they would actually pay above-ceiling prices to small producers?

[T-32]

MR. McCORKLE: Are you suggesting a situation where you might have under an operating agreement where a large producer has a certificate which covers a non-operator small-producer sale and that small producer gets an exemption? Immediately then he is out from any limitations insofar as rate is concerned, and the next day he makes a demand upon the pipeline to pay him a just and reasonable rate of thirty-five cents?

MR. ENDOM: I don't know that that would qualify as reasonable.

MR. McCORKLE: After ten years of trying to get a little justice, I have got a right to use a little license.

Would you agree with that, Mr. Solomon?

MR. HEADY: My question is really intended to be a practical one, in the sense that if the pipelines will not pay more to the small producer than they will to the large producer, then all we are talking about in practicality is exemption from filing requirements. We don't even need to talk about exemption from rate restriction.

On the other hand, if the pipeline contemplates that they will, in a substantial number of instances, be willing to pay more to the small producer than they are willing to pay to the large producers, then we do have a number of very serious problems as to the validity of the proposed regulation, at least in its present form.

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MR. ENDOM: If we were willing to pay a large producer thirty-five cents, and we were willing to pay a small producer thirty-five cents, the problem is, a small producer, I think, would probably (inaudible) that would be contract price, because of limitation on large producer and regulatory (inaudible), he would not be able to collect it. It is not so much a matter of willingness, but a matter of ability to collect.

MR. HEADY: It applis to new contracting as well.

MR. ENDOM: Yes.

MR. HEADY: You have two instances. On the one hand you have a small producer who is presently restricted to a ceiling rate below his contract. Once that exemption is granted, he is immediately entitled to collect his contract price under existing contract. You have another situation in which the pipelines might or might not be willing to pay to a small producer for a new sale a price which is above the ceiling which is applicable to the large producer.

I come back to the point: I don't know what we are dealing with from a factual standpoint, except that on the basis of the Commission's proposed rule making I have to assume that there would be a substantial number of instances in which

pipelines would pay to the small producer a price higher than the ceiling applicable to the large producr.

On that basis, I think we have to face up to the question of validity of the proposed regulation.

[T-34]

MR. McCORKLE: Or negotiate new contracts with a small producer at a higher rate in the contract than they were permitted to do under area rate regulation with those producers who are–

MR. HEADY (interposing): That is another point.

And another point would be whether any type of contractual escalation provisions, which are prohibited to large producers, would be permissible to small producers.

MR. FORGOTSON: Isn't my understanding of the regulation–I had difficulty with the same point–that if a person qualifies for small-producer certificate, they are exempted from everything, procedurally and substantively as far as pricing, as far as everything else–that is my reading of the proposed rule making. And that would exempt them from area ceilings, that would exempt them from getting new contracts and that would exempt royalty owners so they could take their quantity, and it seems to me terrifically terrible feasibility and accounting problems–it would create problems that the gentleman from Phillips talked about. I am not sure, by the way, even if the exemption were granted that pipelines would pay these higher prices, unless of course commanded a considerable reserve. Because I think there would be accounting problems from the pipeline standpoint, too.

MR. HEADY: Let me make one more comment, which is in a sense a repetition of what we stated in our filed comments.

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That is, it seems to me that in large measure we are focusing on the wrong question. That is, if the prices are too low for the small producer to encourage him to engage in exploration, they are likewise too low for the large producer.

The problem and the solution are not in the differences between the small producer and the large producer, but in the

level of rates which are available to everybody. If the rates are too low to encourage exploration, we are not going to solve that problem by talking about distinctions between small producers and large producers.

The real solution there is to get some realistic rates which are applicable to everybody.

MR. McCORKLE: Amen.

MR. ENDOM: Tennessee supports the Phillips statement.

MR. FORGOTSON: So do we.

MR. GILMORE: Does anyone have any further comments they wish to make?

MR. POWELL: My name is William Powell.

My question is: A producer has less than ten billion production under the contract, but three or four years later he finds under the terms of the contract they take fourteen billion.

How much or is all of that fourteen billion exempt?

MR. GILMORE: You are talking about a single contract?

MR. POWELL: Right.

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MR. GILMORE: All of it is exempt.

MR. POWELL: Even if you go above ten billion.

Thank you.

A VOICE: Did you say they were exempt?

MR. GILMORE: They were exempt as to that particular sale. Any future sale made—

MR. McCORKLE (interposing): Suppose he has two or three other contracts that run him over the ten billion—as I understand the question, at the time he sought an exemption he was under ten billion. But as a consequence of subsequent development on the leases covered by that contract, the volumes went very substantially higher, and I understood Mr. Gilmore to say he is exempt.

My question is: suppose at the time he sought that exemption, you put it on a contract basis is what is disturbing me, and suppose at that time the small producer who is seeking exemption has several other contracts, and in the aggregate they

exceed ten billion, he could not get exemption; is that right?

MR. SOLOMON: He has got exemption. Start out that he has one. The question is, what happens to it?

I think, the way this rule is written—and correct me if I am wrong—that he can, once he has got an exemption, and if he makes a new contract which he knows is going to take him over the thing, he can still do it and keep his exemption

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until he makes his next report. Isn't that the way it actually works?

MR. GILMORE: That is right.

MR. HEADY: The way I interpret this statement on Page 3, the answer to Mr. Powell's question is that whenever he goes over ten million total for any reason, he automatically loses his exemption.

MR. McCORKLE: That is the question I was trying to raise and didn't do it, apparently.

MR. HEADY: "The exemption so ordered would continue as long as the small producer's jurisdictional sales do not exceed ten million MCF in a calendar year when aggregated with all jurisdictional sales of affiliates as hereinafter defined."

MR. SOLOMON: When you get into the procedure of working this out, going to make the annual report, nobody is going to even know they exist. I see your ambiguity, but as a practical matter, the Commission is not going to know they exist until they make the annual report.

MR. HEADY: I am not questioning so much the point that you wait until the end of the year. I am questioning the fact that if you started out with a sale which was less than ten million, and under that sale you sell more than ten million, I think at the end of that year the producer would be required to report that he is no longer exempt.

MR. SOLOMON: Frank says that nonexemption would only

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apply to future sales.

MR. McKINNEY: The way to rule is written in Paragraph (c), "Duration of the Exemption," it is within the discretion of

the Commission to terminate the exemption when the small producer no longer qualifies. But even if the Commission were to exercise that discretion and terminate the exemption, nonetheless, as I read the last sentence of the paragraph on top of Page 9, the exemption as it applied to the sales up to ten million would still be effective.

MR. SOLOMON: Under a contract dated prior to the termination; yes.

MR. GILMORE: The question was related simply if he had one contract, and he got his exemption, and two or three years later he was making a sale for more than ten million, whether the exemption would still apply to that particular contract; and the answer was yes. It is only future contracts that would be adversely affected.

MR. HEADY: What if that one contract goes over ten million limit?

MR. GILMORE: Once he gets his exemption, he retains it, after those contracts covered by the exemption.

MR. McKINNEY: I think the thing about it is that the Commission on its own motion or on application terminates such certificate. It appears to leave it within the discretion of the Commission to terminate small-producer certificate. It

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seems to me a better rule would read that the exemption no longer exists; that is, if you are going to have a rule at all.

MR. SOLOMON: We are going to have to have some mechanics.

MR. EHRENKRANZ: Wouldn't the answer to the question be on Page 3 where it says: "Should a producer cease to qualify as a small producer, it would be required to file separate certificate applications and individual rate schedules for future sales, but the exemption previously granted would remain in effect for sales made under contracts dated prior to such termination."

MR. GILMORE: Yes; that is the same way the Permian small producer certificates have worked.

MR. SOLOMON: As long as small producer certificate is subject to the area ceiling, it doesn't really make any difference

as to whether they actually are twice as big as small producer certificate.

MR. EHRENKRANZ: This contemplates they wouldn't be subject to area ceiling.

MR. SOLOMON: That is different.

MR. GILMORE: My reference to the "sameness" was specifically to the problem being discussed.

MR. EHRENKRANZ: I think Mr. Powell's question went to the matter of, without respect to sales previously covered, so if volume ballooned above ten million, it would still be

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covered.

MR. HEADY: Let me ask another embarrassing question.

If the producer, by making these additional contracts, tends to lose his exemption, how does that encourage him to further exploration?

MR. HARKOWAY: Wouldn't that encourage the producer to further exploration to sell into intrastate market and not to the interstate market, where he would then lose his exemption?

MR. GILMORE: A lot depends on what the rates are in respective markets, I assume. He would sell where he could get more money, I would think.

MR. FORGOTSON: I think this gets back to the question raised on our original comments, and that is, what good is this really going to do? Where is the incentive toward further exploration and deliverability of more gas in interstate sales going to come from out of this exemption, and isn't this more—if you will pardon me—of a farcical procedure?

First, because I am not sure that pipelines would pay higher price, and there is the question of whether the exemption would apply anything to the procedural burdens.

Why go through this whole exercise and not come to the real problem, which is a price structure for large and small producers, that is going to encourage exploration and development and protection for sale and resale?

[T-41]

MR. POWELL: I can't speak for the large producers, but I can tell you this: if this ten billion can go to 14 billion and still be exempt–

MR. FORGOTSON: Only for one year.

MR. POWELL: It is from then on.

MR. HEADY: That is one more point, in which the producer is encouraged not to sell to the processing producer, but is encouraged to sell to the pipeline, one more point of discrimination.

MR. BLICKMAN: My name is Blickman. I'm from the Office of Economics.

I would suggest that we differentiate among the different types of markets.

For example, in the Appalachia and Illinois Basin, approximately 98 percent of the rate schedules are filed by small producers. I think the figures are given in the Appalachian-Illinois rate order, and certainly you can't deny that it would be very effective in those marginal areas where you have a preponderance of producers which would qualify under this exemption.

The question is whether we should dismiss the exemption rule making as a whole or whether we should accept it, for those areas where it may be potentially effective.

MR. SOLOMON: If the Commission thought that decision was worth anything–the Appalachian case–this

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rule making, if I understand it, is a rule to upset the order the Commission just issued.

MR. FLANINGAM: If they adopt the rule as proposed here, they would nullify Order 411.

MR. POWELL: A lot of other decisions are made on price.

MR. SOLOMON: Not quite as recent.

MR. POWELL: Still not in being–the Commission is going to follow their policies up until the time they change them. If they change this and adopt them, there is going to be an awful lot of contracts and area rates to be affected all across the board.

MR. SOLOMON: If the New York Commission here today seems to be asking a lot of the same questions that the major producers are asking, and we think they exist, I don't want to be taken as indicating that we think that granting this exemption would have no effect. We are inclined to believe in certain areas it would have serious adverse effect in certain areas.

MR. HEADY: If you postulate a situation of an area in which there is a predominance of small producers, and the theory is that the exemption would encourage exploration by small producers in that area, why not encourage exploration by larger producers also? Why not exempt everybody in that area?

MR. SOLOMON: Ken, the original proposal for

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Appalachia specifically asks for comments on exactly that, as to whether or not the best way of regulating in that area was to not regulate, and presumably the Commission considered that and they have come out with a decision. But your question was raised in that very rule-making procedure.

MR. HEADY: It was not raised in the context of exempting part of the producers and exempting all of them–

MR. BLICKMAN: I would like to answer Mr. Heady.

There is a certain fallacy and logic, and I don't remember the name at this point, but it goes this way:

If a small dose of morphine will relieve pain, why not have a massive dose and relieve the patient of pain for all time? You have to concentrate on the nature of the market structure, on the nature of the supply function in natural gas. I think if you understand the manner in which the small producer complements the large producer, you can validly establish a distinction between the two, which would support this rule making. And as far as I recall in many of the responses, it was emphasized that the small producer does not have any independent price making function, but is rather sheltered under the joint arrangement with the large producer who operates in the nature of a price determiner.

MR. HEADY: What is going to encourage the large producer to continue to explore in this area that you are talking about?

[T-44]

MR. BLICKMAN: I will not attempt to preempt the function of this Commission. I feel much too modest in that respect. I am sure something will emerge, and I prefer to let the matter rest there.

MR. GILMORE: Could I throw one proposal up, either that we take a ten-minute recess, if it is contemplated that the discussion will be on for a while, or is it contemplated that the discussion is close to termination?

A VOICE: Let's try to finish.

MR. McKINNEY: In reference to the gentleman from the Office of Economics, his comments on selective exemption here. I think the Commission pointed out in its Order on Page 2 that impact on the consumer of exempting small producers from regulation should thus be minimal.

All the other questions and legal questions of discrimination aside, it seems to me that if this rule making were to take on any legality at all, that at the very least the sales by the small producers to other producers, primarily those sales occur in processing-plant operations, and I am here today speaking for Signal Oil & Gas Company, and they have substantial processing-plant operations, just not as big as Phillips, but like Phillips, that at the very least that you have to also exempt the sale by the processing-plant operator on those volumes that are sold him by the small producer which are exempt.

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Now, if those volumes are minimal in their impact on the consumer, if they are sold directly to the pipeline, they are just as minimal if the processing-plant operator is allowed to sell on an exempt basis also. So there can't be any impact on the consumer if the Commission's statement is true here as far as small producers themselves are concerned.

By the same token, you are alleviating at least one problem, a very formidable problem for processing plant operators, and you are permitting the use in the same facilities, the gathering facilities, the processing-plant facilities at lesser cost, I might add, to the consumer, by exempting the sale by the processing-plant operator. So I think if this rule making is to take on any validity at all, if the Commission intends to go on

and act on it, that at the very least they do have to exempt the volume of sales that are made by the small producer to other producers. If it is minimal in one instance, it is just as minimal when it is sold by the second producer.

MR. GILMORE: Jim, how much gas does Skelly purchase from small producers—Signal; excuse me.

MR. McKINNEY: We tried to determine that before we met here today.

First of all, let me say that 99 percent-plus of the gas Signal sells from its processing plant is purchased from other producers. They have very, very little production of

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their own. Almost 100 percent is purchased from other producers.

Now, I don't want to be held to these figures at all, because this has been a very, very cursory study. We don't know what is going to constitute a small producer and what isn't going to constitute a small producer, but it looks to us like that between 60 and 70 percent of the gas that we sell presently comes from small producers.

I don't have any idea in total volume. There is substantial volume.

MR. HEADY: To give you some illustration along that line, and again I can't be specific in terms of quantity, but we have fairly recently entered into a contract to sell gas to Panhandle Eastern from the Douglas area of Wyoming. I would venture that a very large part of that gas is being purchased from producers who would qualify as small producers under this exemption, because this was an area that was essentially developed for oil production by small producers. I think that under this proposed regulation we would not have been able to go into that area and establish a plant and be able to buy that gas simply because the small producers would not have been willing to sell to us; and I don't think I would have sold to us either under those circumstances.

[T-47]

MR. SOLOMON: Is this oil well gas rather than gas well gas problem?

MR. HEADY: It is both. In large measure, it is casing head, but there is beginning to be some gas well gas developed in the area also. Most of that is brought under percentage type contract, which pay the producer a percentage of the residue proceeds and a portion of the liquids extracted.

MR. SOLOMON: As a practical matter, you people are performing the gathering function for the pipeline, aren't you?

MR. HEADY: In this particular instance the pipeline installed the gathering system, and we are paying them for the use of that pipeline system, but we are performing the purchasing activities and a part of the gathering actities, the connection of individual wells, for the pipeline companies, yes.

MR. SOLOMON: In my period of time on the Commission Phillips had some gathering lines which were fairly extensive.

(Discussion off the record.)

MR. HEADY: If the producer, by making a percentage sale to us, would be eating into his ten million exemption, he would simply be precluding himself from making further exemption sales down the line. There wouldn't be any logic in his entering into percentage sale contract with another producer under those circumstances.

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On the other hand, the pipeline could go in and buy him everything.

I would like to say that we made the comment in our filing that frankly we think that this proposal would be the greatest incentive to intrastate sales since the opinion of 1968. Once the producer approaches his ten million limit, he has no further interest in making any interstate sale. His interest in interstate sales is terminated as of that point. He is doing his exploration for intrastate.

MR. GILMORE: Are there any further comments on any of the issues posed in this proceeding?

MR. ENDOM: There are a lot of issues, as I said before, that are not being discussed. We are not precluded because of later developments on things that you cannot see now, because of our failure to comment–

MR. GILMORE (interposing): No.

MR. SOLOMON: If you are going to close off, I would second a suggestion that was made earlier that if the Commission does wish to proceed with this docket, it would be most useful to the Commission–my guess as well as everybody else–before the final rule was put out, in light of these comments and written comments, to have a new notice–

MR. HEADY: I have one other question that has occurred to me. It relates to the question of the extention of the exemption to present certificate and rate procedures.

[T-49]

I can't give you specific instances, but I am sure that we have some of the situations in which we are purchasing gas from a small producer who could qualify under this exemption.

Our sale is being made at a price increase which has been suspended and is subject to possible refund. The producer is not selling to us under a percentage contract, but selling to us under a contract in which he has his own rate schedule and has made his own rate filing.

Would it be contemplated that that producer, when he became exempted under this proposal would be exempted from any refund obligations under his contract?

MR. GILMORE: For the period prior to his exemption?

MR. HEADY: Yes.

MR. GILMORE: The Commission, in its notice, simply threw that question up for grabs and asked for comments.

MR. HEADY: Let me extent my question a bit further. Our experience on this refund question is that a number of parties to various rate proceedings have taken the position that the producer obligations to refund is to refund every thing which he may have collected over the ceiling price, over the ultimately determined just and reasonable rate, regardless of what the consequences of that refund may be.

For example, in our own rate case a number of years back, although the Commission found that our costs substantially exceeded our total revenues, there are a number of parties–

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Wisconsin, California, I think even the New York Commission contended that we had an obligation to refund over what the Examiner there determined to be the just and reasonable levels, even though that would simply bring about a further deficit in our total revenue.

And I can visualize a situation here in which a small producer might be relieved from his obligation to refund either retroactively or forward from the date, but our obligation to refund comes about at some later date, and the contention would be made that Phillips had to refund over this whatever level was determined, whether or not we got any refund from a small producer, and it certainly seems to me that that certainly puts us in a rather unique position as well and I am sure we have that type of situation.

MR. GILMORE: I would be surprised if you didn't.

MR. HEADY: We have had singularly lack of success in generating any sympathy of what can visualize they are going into the consequences of a particular refund may be upon us, and I can visualize they are going into the same problem here.

MR. GILMORE: Are there any further comments?

MR. ENDOM: Will a day be fixed to show transcript corrections?

MR. GILMORE: Let me suggest that anybody who wishes to make transcript corrections make them prior to Christmas.

(Discussion off the record.)

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MR. GILMORE: If there are no further comments, I suggest we adjourn.

(Whereupon, at 11:35 o'clock, a.m., the conference was concluded.)

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR 154.91, 154.104, 154.110, 157.40, 250.10, 250.11]

Before Commissioners: John N. Nassikas, Chairman;
Lawrence J. O'Connor, Jr.,
John A. Carver, Jr., and
Albert B. Brooke, Jr.

Exemption of Small Producers) Docket No. R-393
From Regulation)

ORDER NO. 428

ORDER ESTABLISHING BLANKET CERTIFICATE PROCEDURE FOR SMALL PRODUCER SALES AND PROVIDING RELIEF FROM DETAILED FILING REQUIREMENTS

(Issued March 18, 1971)

The Commission on July 23, 1970 issued a notice of proposed rulemaking in this proceeding (35 F.R. 12220, July 30, 1970) proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers as defined therein. The proposal did not cover either percentages sales made by small producers pursuant to percentage sales contracts or sales to interstate pipeline companies by their affiliates.

In response to the notice comments were filed by seventy three parties, including producers, pipeline and distribution companies, associations representing producer and distributor interests, and the California and New York State Commissions. A conference was also held in this case on December 8, 1970. The small producers support the exemption as originally proposed, while the large producers either oppose such exemption or question its advisability. Pipeline and distribution companies are divided on the issue, with one expressing outright opposition and some of the others suggest-

ing extensive modifications. The American Public Gas Association and the California and New York State Commissions also oppose the proposal.

The small producers argue that traditionally they have been very aggressive in searching for new gas reserves but that such activity has been greatly curtailed in recent years, largely because of restrictive regulation. They further state that their drilling efforts often prove or disprove the presence of gas bearing structures, and that the information gained is useful to all producers, large and small, in their search for new gas supplies. Because of uncertainties in regulated prices, they claim that discontinuation of regulation, rather than higher ceiling prices alone, is necessary to provide the incentive required to encourage a substantial increase in exploratory drilling.

Opponents of the proposed exemption, on the other hand, contend that the proposal will lead to higher natural gas prices for small producer sales resulting ultimately in higher consumer rates. They also disagree with the view that the impact on the consumer will be minimal. In addition, they question the Commission's authority to exempt small producers.

We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no room for administrative judgment and discretion. Mr. Justice Clark, speaking for the Court in *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964) recommended that the Commission consider procedures for the exemption of small producers. And, in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968), the Court, while recognizing that the language of Sections 5 and 7 is without exception or qualification, noted the power of the Commission under Section 16, for purposes of its rules and regulations, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

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One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By our action herein, we are taking an important step forward to meet this responsibility. Upon review of the contentions made by the various parties, we have decided that both existing and future sales of small producers shall be regulated in the manner hereinafter provided.

Such action should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas. Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the administrative burdens connected with processing small producer filings.

We have reviewed the impact of our action on 96 pipelines that purchase gas, based on 1969 statistics in Forms 2 and 2-A. This shows, for example, that Kansas-Nebraska's purchases from small producers amount to 21.63% of its total gas supply including purchases from all producers, pipelines and its own production. Comparable percentages for many of the small gather-type pipelines were quite high. However, many of the major pipelines show less than 10%. Others show no purchases at all from small producers. The overall weighted average for the 96 companies was 7.54% (or 10.52% after eliminating all pipeline to pipeline sales).[1]

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[1]These statistics do not include resales to pipelines by large producers of gas purchased from small producers.

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The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers sales. We shall also provide certain other safeguards against unreasonably high small producer prices, as hereinafter discussed, to assure adequate protection for the consumer.

We are concerned that favored nation, price redetermination and spiral escalation provisions in small producer contracts may have an adverse impact on consumers. The filing of contracts containing such clauses executed on or after April 2, 1962, has previously been proscribed by the Commission as contrary to the public interest.[2] There is, of course, no objection to the use of these provisions to the extent the resulting rate does not exceed the applicable area just and reasonable rate ceiling, as provided in our *Permian* opinion, 34 FPC 159, 236, or, where none is available, the applicable area guideline initial rate ceiling. But these provisions should not be permitted to increase the contract price above such level. To do otherwise would clearly be contrary to the public interest. Consequently, this order will limit the use of these indefinite price escalation provisions by small producers.

The New York Commission contends that the proposed exemption may open the way for large producers to sell their gas in interstate commerce free from Commission regulation by selling their reserves in place to small producers, who would in turn resell the reserves under a conventional (exempt) sales contract to an interstate pipeline. To forestall this possibility, we shall provide that the exemption authorized here for small producers shall not apply to jurisdictional sales made by them where the gas reserves relating thereto were acquired by the

[2] Order No. 242, 27 FPC 339; *F.P.C.* v. *Texaco Inc.*, 377 U.S. 33.

purchase of developed reserves in place from a large producer. In such circumstances the small producer will be required to obtain separate certificate authorization.

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Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee) in its comments inquired as to whether a pipeline will be assured of recouping its cost of purchased gas if it pays the "going" field price to a small producer. Any question as to the propriety of the price paid by a pipeline to a small producer will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified. The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent. We shall also require pipeline purchasers to file, within 60 days of the execution thereof, every new contract or contract amendment for the purchase of natural gas from a small producer whose sale is regulated by the terms of this order.

The exemption proposed in the July 23 notice was applicable, *inter alia,* to sales made by a small producer to a large producer, but not to the resale of such gas by the large producer. A number of large producers argue that if sales by small producers to them are regulated by this order, there is no justification for not also applying consistent treatment to the resale of such gas. They warn that if large producers in these circumstances are not exempt they will be forced to sell gas purchased from small producers under new contracts in intrastate commerce in the future or to forego such small producer supplies, thus limiting the usefulness of their existing gathering and plant facilities. They also point out that if these small producer sales are made directly to an interstate pipeline purchaser under new contracts, it will be necessary for the purchaser to construct new facilities to take such gas which would duplicate existing facilities of large producers. With

regard to existing sales, they claim that it would be discriminatory to prevent large producers from increasing their resale rates to account for higher rates paid to small producers.

We think it important to encourage large producers to continue to utilize their existing facilities for the resale in interstate commerce of gas purchased from small producers.

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For this reason we shall permit large producers with respect to the resale of gas sold to them by small producers pursuant to the subject exemption to file rate increases authorized by contract, thus permitting them to maintain the contract price differential between their purchase and resale prices. These filings shall be accepted, without refund obligation, as long as the price differential is consistent with prevailing price differentials in the area and as long as the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for by large producers or the prevailing market price for intrastate sales in the same producing area. We shall require large producer purchasers, like pipeline purchasers, to file any new contracts or contract amendments with small producers.

Some of the large producers contend that royalty interests should be excluded specifically from any exemption granted to small producers.[3] We disagree. The royalty interests stand in the same shoes as the working interest owners. Consequently, if a royalty interest relates to a small producer sale, such interest shall be exempt, but if it applies to any other sale it will not be exempt.

Consolidated Gas Supply Corporation (Consolidated) urges that small producers be exempt from compliance with Section

[3]The question of this Commission's jurisdiction over royalty interests is now pending before the United States Court of Appeals for the District of Columbia in *Mobil Oil Corporation, et al.* v. *F.P.C.*, Nos. 23463, *et al.*

7(b) with respect to the abandonment of their small producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment. Consolidated points out that the vast majority of these are routine matters occurring either because of depletion of production or because continuance of the sale is uneconomic, and in these situations the purchaser routinely consents to the abandonment. But, Consolidated claims that in the rare situation where there is a dispute as to whether a small producer sale should be discontinued there should be some Commission procedure available for the resolution of such dispute.

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We think it important to retain control over all abandonments of jurisdictional sales. For this reason, small producers shall be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein.[4] We shall also require purchasers to notify us of the cessation of deliveries by a small producer regulated by the terms of this order within 60 days of such cessation.

Austral Oil Company Incorporated (Austral) suggests that the definition of "affiliated producers" be clarified to make it clear that such term does not include small producers who have participated in joint ventures, nominee agreements and similar contractual arrangements in order to spread the risk of exploration and development and for operating convenience, unless such agreements otherwise establish the power to direct or cause the direction of the management policy of a person. The suggestion is a good one and we shall adopt it.

[4]If a contract for an exempted sale of gas expires and is not extended or replaced by a new contract, the small producer must continue the sale of such gas unless the pipeline consents to abandonment or the producer obtains abandonment authorization. Moreover, in such circumstances the small producer is not entitled to collect any rate in excess of the highest rate permitted under the expired contract for the sale of such gas unless it files a notice of change in rate in accordance with Section 4(d) of the Act.

Tennessee has raised a question as to the applicability of the small producer exemption to a sale by a non-signatory small producer under a large producer's rate schedule. The exemption is applicable to such sale by a small producer.

The Commission proposed in the July 23 notice to waive the provisions of Section 154.63 of the Commission's Regulations to permit the tracking by pipeline purchasers of rate increases resulting from the exemption of small producers

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in those situations where a purchaser did not otherwise have the right to make a tracking filing. Consolidated claims that the collection of a tracking increase by a pipeline should not be subject to reduction and refund, as provided in the July 23 notice, inasmuch as the small producers will have no potential refund obligation with respect to their increased rates.

Small producers will have no refund obligations with respect to increased rates, if any, collected for sales regulated hereunder to pipelines, and, as a result, pipelines will receive no refunds from small producers to flow through. However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in (1) a pipeline rate case or (2) a proceeding involving only the tracking increase. Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. The Commission shall consider all relevant factors. See *Permian Basin Area Rate Cases,* 390 U.S.

747 (1968); *Austral Oil Co.* v. *F.P.C.*,__F. 2d__(Fifth Circuit 1970, slip opinion dated March 19, 1970, No. 27492, et al.) In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests.

Sales from small producers to large producers will likewise carry no refund obligations. However, if the resales by large producers to pipelines reflect new small producer sales at prices in excess of the previously discussed standard, the large producers' rates will be subject to suspension and refund.

Accordingly, the provisions of Section 154.63 are hereby waived to permit pipeline purchasers or pipelines purchasing from such pipeline purchasers to file rate increase applications to track small producer rate increases resulting from the exemption of small producers pursuant to the provisions

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of this order, provided that pipelines filing such an adjustment submit supporting schedules showing the computation and provided further that such filing may be made only if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or orders, affect the pipeline's average cost of purchased gas by one mill or more. The Commission reserves the right to require a pipeline to file all information required by Section 154.63 if it deems such information to be necessary.

Many of the small producers urge us to relieve them of any potential refund obligations they have under increased rates collected in Section 4(e) rate suspension proceedings or under initial rates collected under temporary certificates issued pursuant to Section 7. These matters more properly should be disposed of in appropriate area proceedings after the refund obligations are determined.

In view of the foregoing, we shall revise Section 157.40 so as to establish a blanket certificate procedure for small producers,

applicable to all small producer sales made nationwide under existing and future contracts.[5] Small producers under this procedure shall be relieved of all filing requirements under the Natural Gas Act and the Commission's Regulations, except for the annual statement required by Section 154.104 of the Regulations and except for compliance with the aban-

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donment provisions of Section 7(b) of the Act. By subsequent order we shall amend Section 250.11 to provide for a revised annual statement to be filed by small producers regulated hereunder commencing in 1972.

Producers who have received small producer certificates prior to the issuance of this order, or who have applied and qualify but have not yet received such a certificate, will not be required to file new applications seeking exemption, unless otherwise directed. Commission orders relating to those small producers who have applied and qualify for a certificate will be issued without any further action on the part of the producers involved. Such certificates, regardless of the date of issuance, will be effective as of 45 days from the date of issuance of this order. Similarly, all of those small producers who file applications for a blanket certificate within 45 days from the date of issuance of this order and who are entitled to coverage thereunder will also receive certificates which will be effective as of 45 days from the date of issuance of this order, regardless of the date of issuance of such certificate. With regard to those producers who have small producer certificates, the existing certificates, without further order of the Commission, shall be deemed to cover, as of 45 days from the issuance of this order, all small producer sales of those producers which are exempt under the provisions of this order. The 45 day period will give

[5] Notwithstanding the provisions of this order, a small producer may file for the minimum rate authorized by the Commission for any area.

the pipeline purchasers and their distribution customers time to track any increases resulting from this action.

We intend to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers.

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The Commission finds:

(1) The notice and opportunity to participate in this rulemaking proceeding through the submission, in writing, of data, views, comments and suggestions are in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code.

(2) The action taken herein is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modifications adopted herein to the amendments proposed in the notice of this proceeding are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

The Commission, acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o, *orders*:

(A) Parts 154 and 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations, are amended as follows:

1. Part 157 is amended by revising Section 157.40 to read:

"§ 157.40 Exemption of small producers from certain filing requirements.

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(a) *Definitions*

(1) A 'Small Producer' is an independent producer of natural gas as defined in § 154.91

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of this chapter, who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of 'affiliated producers' are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year. As used in this section, the term 'jurisdictional sales' includes volumes of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this section has an interest in such sales, but does not include sales made pursuant to percentage sales contracts.

(2) 'Affiliated producers' are persons who, directly or indirectly, control, or are controlled by, or are under common control with, the applicant producer. Such control exists if the producer has the power to direct or cause the direction of, or as a matter of actual practice does direct, the management and policies of another producer, whether such power is exercised alone or through one or more intermediary companies, or pursuant to an agreement, and whether such power or practice is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, relationship of blood or marriage, or any other direct or

indirect means. For the further purposes of this section, the term 'agreement' shall not include any agreement for the operation of a natural gas producing property or a plant processing natural gas or any joint venture, partnership, nominee, or other type of agreement pertaining to the joint exploration for and development and operation of oil and gas properties, unless such agreement otherwise establishes the power of one producer to direct or cause the direction of the management and policy of another producer.

(3) 'Small producer sales' are (i) sales by a small producer of his own interests under his own contracts; (ii) sales of all interests under a small

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producer's contract if producers not qualifying as small producers have interests which in the aggregate are no greater than 12½ percent; and (iii) sales of a small producer's interests under another producer's contract.

(b) *Procedure for securing blanket small producer certificate.*

(1) Small producers may apply for a blanket certificate to cover all existing and all future jurisdictional sales that do not raise the producer's total jurisdictional sales on a nationwide basis above 10,000,000 Mcf during any calendar year. Applications by these producers shall include the following information: (i) total jurisdictional sales on a nationwide basis for the year preceding the application; (ii) a list of outstanding certificates and rate schedules together with names and percentage of interest of other

interest owners under such rate schedules; (iii) a list of outstanding rate schedules of others in which applicant owns an interest together with applicant's percentage of interest; and (iv) the names of all owners (stockholders, partners, joint venturers, etc.) of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company, and any positions such owners may hold with another natural gas company.

(2) An applicant for a blanket certificate who has no outstanding certificate issued by, or rate schedule filed with, this Commission for the sale of natural gas shall include the following information in his application:

(i) a list of all contracts to sell natural gas in interstate commerce,

(ii) source of production, total rate and the annual volume delivery obligations

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of the producer under each such contract, together with names and percentage of interest of other interest owners under each such contract, and

(iii) a list of owners of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company and any position such owners may hold with another natural gas company.

(3) The application shall contain the information required by the form set out in

§250.10 of this chapter. A conformed copy shall be served upon each of the applicant's purchasers.

(c) *Exemption under blanket certificate.* Small producers certificated hereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract. However, no small producer shall be relieved from compliance with Section 7(b) of the Natural Gas Act with respect to any small producer sale exempted hereunder. The exemption authorized herein shall not apply to any jurisdictional sale made by a small producer where the gas reserves relating thereto were acquired by the purchase of developed reserves in place from a large producer.

(d) *Duration of the exemption.* The exemption authorized hereunder shall remain in effect for each small producer until the Commission on its own motion or on application terminates such certificate because the producer no longer qualifies as a small producer or fails to comply with the terms of the exemption. Upon such termination the producer will be required to file separate certificate applications and individual rate schedules for future sales but the exemption will still be effective as to those made under contracts dated prior to such termination.

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(e) *Limitation on contractual provisions.* No Small Producer granted exemption under paragraph (c) above shall charge or collect any rate for a small producer sale of natural gas in excess of the applicable area just and reasonable

base rate ceiling, or, where none is available, the applicable area guideline initial rate ceiling, where the contractual right to such rate is based upon any contractual provision which would not be permitted by subsections (a), (b), (b-1) and (c) of Section 154.93. For the purposes of this limitation, it shall make no difference whether the contract was executed prior to or subsequent to April 3, 1962.

(f) *Filings by large producers with respect to related resales.* A large producer may file for the price specified in its related contract for the resale of any natural gas sold to it by a small producer pursuant to the exemption authorized hereunder. Any such rate filing shall be accepted if the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area, and if the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area.

(g) *Filing of contracts and notification of abandonment.* Pipeline purchasers and large producer purchasers shall file, within 60 days of the execution thereof, each new contract and each contract amendment dated on or after March 18, 1971, for the sale of natural gas to them by a small producer pursuant to the exemption authorized hereunder and shall notify this Commission of the cessation of deliveries made by a small producer pursuant to the exemption authorized hereunder within 60 days of such cessation.

2. Part 154 is amended by revising paragraph (f) of § 154.91, § 154.104 and § 154.110 to read:

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"§ 154.91 Applicability.

* * * * *

(f) *Filings by certain non-signatories.* Where the operator and the signatory co-owners in a particular sale are exempt with respect to such sale pursuant to § 157.40, and where any non-signatory co-owner's interests are not covered by such exemption, such co-owner may file rate schedules, rate changes, or certificate applications with respect to such interests notwithstanding the provisions of paragraph (d) of this section.

* * * * *

§ 154.104 Annual statements by small producers.

Annual statements certifying to the matters enumerated in the form set out in §250.11 of this chapter shall be filed by all producers, either individually or by groups, who have been exempted under the provisions of Section 157.40. The statements shall be submitted by April 1 of each year for the preceding calendar year.

* * * * *

§ 154.110 Applicability of §§ 154.92 through 154.102.

Sections 154.92 through 154.102 shall apply only to those persons specified in § 154.91 and shall not apply to small

producer sales which are exempted under §157.40 of this chapter."

(B) Part 250 of Subchapter G, Chapter I, Title 18 of the Code of Federal Regulation is amended by revising § 250.10 as follows:

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The title of § 250.10 is revised to read:

§ 250.10 Application for small producer exemption

The text of § 250.10 is revised by substituting therefor the form entitled "Application for Small Producer Exemption" as set out in Attachment A hereto.

(C) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

(D) The amendments adopted herein shall be effective 45 days from the date of issuance of this order.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Acting Secretary.

§ 250.10

APPLICATION FOR SMALL PRODUCER EXEMPTION

(See § 157.40(b)(3))

NOTE: Independent Producers of natural gas whose total jurisdictional sales on a nationwide basis for the preceding calendar year, combined with those of "affiliated producers," were not in excess of 10,000,000 Mcf may file the information called for in this form for a Small Producer Exemption to sell gas (in four copies). Include volume of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within Section 157.40 has an interest in such sales. Do not include sales made pursuant to percentage sales contracts. If insufficient space is given for a complete answer, continue the answer on the reverse side or on a separate sheet, noting the relevant number.

1. NAME OF APPLICANT	2. STATE OF ORGANIZATION
3. LOCATION OF PRINCIPAL PLACE OF BUSINESS	4. TYPE OF ORGANIZATION (Corporation, partnership, joint venture, etc)

5. PERSON RESPONSIBLE FOR APPLICATION

NAME AND TITLE	MAILING ADDRESS

6. TOTAL JURISDICTIONAL SALES VOLUMES AT ______ PSIA FOR CALENDAR YEAR PRECEDING APPLICATION. (If more than one applicant is to be covered by this exemption, give the total jurisdictional sales volumes of each applicant separately.)

7. LIST ALL CERTIFICATES PRESENTLY HELD BY DOCKET NUMBER AND LIST ALL CONTRACTS ON FILE WITH THE COMMISSION AS RATE SCHEDULES BY RATE SCHEDULE NAME AND NUMBER. INCLUDE IN SUCH LISTING APPLICANTS' INTERESTS IN GAS SALES COVERED BY OTHER PRODUCERS' CERTIFICATES AND RATE SCHEDULES. LIST ALL INTEREST OWNERS AND THE AMOUNT OF THEIR INTEREST FOR EACH SALE TO BE COVERED BY THIS EXEMPTION. (See reverse side for reporting)

8. LIST ALL OWNERS OF MORE THAN 10 PERCENT INTEREST IN APPLICANT: (A) INDIVIDUAL NAME; (B) PERCENT OF OWNERSHIP

9. LIST ALL INTEREST OWNED BY THE INDIVIDUALLY NAMED OWNERS IN OTHER NATURAL GAS COMPANIES: (A) INDIVIDUAL NAME; (B) COMPANY NAMES; (C) PERCENT OF APPLICANT OWNERSHIP.

10. LIST FOR EACH OWNER THE POSITIONS HELD BY THESE INDIVIDUAL OWNERS IN APPLICANT COMPANY OR ANY OTHER NATURAL GAS COMPANY.

11. IS APPLICANT OR ANY INDIVIDUAL OWNER LISTED, AFFILIATED WITH ANY PURCHASER OF JURISDICTIONAL GAS FROM APPLICANT? (If so list name of buyer and seller for each sale and nature of affiliation.)

SIGNATURE	TITLE	DATE

FPC Form 314-A
Rev (6-72)

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SALES UNDER RATE SCHEDULE OF APPLICANT

APPLICANT	DOCKET NUMBER	RATE SCHEDULE NUMBER	INTEREST OWNERSHIP UNDER AN'T SCHEDULE NAME	PERCENT INTEREST

APPLICANTS SALES UNDER RATE SCHEDULE OF OTHERS

OTHER SELLER	DOCKET NUMBER	RATE SCHEDULE NUMBER	APPLICANTS PERCENT INTEREST IN RATE SCHEDULE

NOTE: Place an asterisk (*) after each co-owners name whose interest is not to be covered by the Small Producer Exemption applied for.

FPC Form 334-A
Rev (6-72)

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APPLICATION FOR REHEARING

FEDERAL POWER COMMISSION ORDER NUMBER 428

DOCKET NUMBER R-393

EXEMPTION OF SMALL PRODUCERS FROM REGULATION

ORDER ISSUED, MARCH 18, 1971

COMES NOW, James M. Forgotson, Sr. of 409 Beck Building, Shreveport, Louisiana 71101, an independent producer of natural gas with production in Louisiana, Texas and Arkansas and applies through his designated attorney to the Federal Power Commission for a rehearing in the above designated matter, pursuant to Section 1.34 of the Rules of Practice and Procedure of the Federal Power Commission and Section 19(a) of the Natural Gas Act (15 U.S.C. Sec. 717(r)(a)).

Specifically the applicant contends that the Federal Power Commission lacks jurisdiction to issue order Number 428. This is because by the passage of time, the change in the conditions of the natural gas and energy situation and market in the United States and the world, technological changes, and actual experience with regulation of independent producers of natural gas for approximately seventeen years, the determination by the Supreme Court of the United States in *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954) that the Federal Power Commission has

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jurisdiction over independent natural gas producers, while constitutional then, is now unconstitutional. Specifically, the Supreme Court of the United States has held in *Abie State Bank*

v. *Weaver,* 282 U.S. 765 (1931) that statutes which were once constitutional can become unconstitutional by the passage of time and actual experience encountered in the administration and application of said statutes. The applicant contends for the same reasons set forth in his original written comments, as submitted to the Commission in the Rulemaking Procedure leading to issuance of Order 428, that regulations, particularly commodity price controls by the Federal Government, in the absence of any showing of war emergency or monopoly, *applied solely to one fuel or energy commodity, namely–processed natural gas*–constitutes such invidious discrimination against the independent producers thereof that it violates the guarantees of the Constitution of the United States against the deprivation of property without due process of law. *Morey* v. *Doud,* 354 U.S. 457 (1957).

Specifically, the applicant requests that the Commission give consideration to this question of jurisdiction over all independent producers in light of the guarantees of the Fifth Amendment to the Federal Constitution, clearly set out in the applicant's original comments on this matter.

Furthermore, the applicant directs the attention of the Commission to the Commission's own activities in considering licenses for cryogenic

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tanker importation of liquified natural gas from Algeria at a proposed initial rate of 365 billion cubic feet annually, to cope with the current domestic gas and energy shortages, at prices during non-peak shaving conditions several times the currently permitted well head prices for domestic natural gas. Those prices themselves assume that the concept is feasible, tanker capacity is available, and the claimed processing and shipping prices of the liquified gas hold firm. This action is occurring while the domestic industry and the nation are suffering from

several years of decreasing gas reserves and ratios of gas discoveries to consumption, directly attributable to a venture capital shortage created by the Commission's own unconstitutional price control practices. This is a clear indication of the total failure of the Commission and the Natural Gas Act as applied to *all* independent producers to protect the consumers against unreasonable or high prices or maintain a healthy domestic industry. Adding the aspirin of Order 428 to treat the pains of the brain tumor created by the Commission's regulation of independent producers will do nothing to solve the basic problem, but can serve as a cover-up that "something" is being done.

Respectfully submitted,

/s/ Edward H. Forgotson

Edward H. Forgotson
Stroud & Smith
1407 Main, Suite 1300
Dallas, Texas

Attorneys for Applicant

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AFFIDAVIT

March 29, 1971

STATE OF TEXAS)
)
COUNTY OF DALLAS)

I, Edward Herman Forgotson, attorney for James M. Forgotson, Sr., having been duly sworn, testify and depose that the contents of this Application for a Rehearing in the F.P.C. Docket Number R-393 proceeding are true and correct.

/s/ Edward Herman Forgotson

Edward Herman Forgotson

SUBSCRIBED AND SWORN TO BEFORE ME this 29th day of March, 1971.

/s/ Kathryn E. DeCarlucci

Notary Public in and for
Dallas County, T E X A S

My Commission Expires:
June 1, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR 250.11]

Before Commissioners: John N. Nassikas, Chairman; Lawrence J. O'Connor, Jr., and Albert B. Brooke, Jr.

Exemption of Small Producers From Regulation) Docket No. R-393

ORDER NO. 428-A

ORDER REVISING ANNUAL STATEMENT

(Issued April 9, 1971)

The Commission on July 23, 1970 issued a notice of proposed rulemaking in this proceeding (35 F.R. 12220, July 30, 1970) proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers as defined therein. Thereafter, the Commission in its Order No. 428 issued March 18, 1971[1] established a blanket certificate procedure for small producers applicable to all small producer sales made nationwide under existing and future contracts.

The Commission indicated in Order No. 428 that by subsequent order it would amend Section 250.11 to provide for a revised annual statement to be filed commencing in 1972 by small producers operating under blanket certificates issued pursuant to that general order. The annual statement to be submitted by small producers has been expanded to show, in addition to the total jurisdictional sales volume, a breakdown of such sales by area, volume, purchaser and price.

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The Commission finds:

[1] 36 F.R. 5598, March 25, 1971

(1) The notice and opportunity to participate in this rulemaking proceeding through the submission, in writing, of data, views, comments and suggestions are in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code.

(2) The action taken herein is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modifications adopted herein to the amendment proposed in the notice of this proceeding are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

The Commission, acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o, *orders*:

(A) Part 250 of Subchapter G, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising § 250.11 as follows:

The title of § 250.11 is revised to read:

§ 250.11 Annual statement for independent producers holding small producer exemptions

The text of § 250.11 is revised by substituting therefor the form entitled "Annual statement for independent producers holding small producer exemptions" as set out in Attachment A hereto.

(B) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

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(C) The amendment adopted herein shall be effective 30 days from the date of issuance of this order.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Acting Secretary.

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Attachment A - Page 1 of 1

§250.11 Annual Statement for Independent Producers holding Small Producers Exemptions.

(See § 157.40 of this chapter)

I hereby certify that total sales subject to the jurisdiction of the Federal Power Commission made by the undersigned and its affiliates for the calendar year 19__ were ____________________ Mcf at 14.65 psia. The pertinent information relating to each of these jurisdictional sales is as follows:

Area	Purchaser	Volume	Price

____
(Name of Small Producer)

____
(Signed)

____
(Representative Capacity)

____
(Docket No.)

FPC Form 314-B
(3-71)

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers)
From Regulation) Docket No. R-393

APPLICATION FOR REHEARING AND RECONSIDERATION OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

Now comes the Independent Natural Gas Association of America (INGAA) and, pursuant to Section 19(a) of the Natural Gas Act (15 USC 717r(a)) (Act) and Section 1.34 of the Regulations under the Act, submits its Application For Rehearing and Reconsideration of Order No. 428 issued herein on March 18, 1971.

The person upon whom service of pleadings, documents or communcations with respect to this matter should be made is:

Jerome J. McGrath, Vice President and
General Counsel
Independent Natural Gas Association of America
1660 L Street, N. W.
Washington, D. C. 20036
293-5770

I

INGAA is a non-profit national trade association representing virtually all of the major long distance natural gas transmission lines in the United States, all of which are subject to the jurisdiction of the Commission under the Act. Most, if not all of these companies are directly affected by the Commission's

Order No. 428 herein. Its membership also includes producers and distributors of natural gas.

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II

In this rulemaking proceeding,[1] the Commission proposed to exempt from regulation under the Act all existing and all future jurisdictional sales made by small producers, i.e., those whose jurisdictional sales, including those of affiliates, do not exceed 10,000,000 Mcf in a calendar year. Under the proposal as noticed, such small producers would be exempted from "all provisions" of the Act and the Commission's Regulations otherwise applicable to the jurisdictional sales covered by such exemptions, except for the requirement that they submit annually a report setting forth their total volume of jurisdictional sales. Further, the Commission proposed to permit pipeline purchasers to file rate increases limited to tracking rate increases resulting from the exemption of small producers, waiving, where necessary, the requirement for supporting schedules under Section 154.63 of the Regulations, provided such schedules are submitted within four months from the date of the pipeline's increased rate filing. The Commission also stated that the rate or rates as revised by such tracking filings could be collected subject to reduction and refund from the effective date of such rate increase. No mention was made in the Notice that the Commission intended to regulate small producers through, and at the expense of, the pipeline companies. On the basis of the proposal as

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noticed, INGAA did not file comments, taking a neutral position on the question at issue. Order No. 428, INGAA submits,

[1] Notice of Proposed Rulemaking dated July 23, 1970.

goes far beyond the scope of the rule as noticed herein to the detriment and serious injury of the interstate pipelines and, is therefore unlawful and in violation of the Administrative Procedure Act (5 USC 551, et seq.) and should be set aside, modified, or re-noticed as hereinafter set forth.

III

The Notice of Proposed Rulemaking in this docket, dated July 23, 1970, gave not the slightest hint that pipeline companies would be required to bear the full burden of small producer regulation. The notice simply indicated that small producers would be free of area price limitations in future sales contracts, and, while stating that pipelines would be permitted to file tracking increases, there was no indication that pipelines could file such increases only "if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or standards, affect the pipelines average cost of purchased gas by one mill or more."

Most egregious, however, the Notice gave absolutely no indication that small producer regulation would be carried on at the "pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales" (Order, p. 4). Consequently, since there was no reference to pipeline level regulation in the Notice, all the intrastate sales

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reference guidelines are novel, and appear in the Order for the first time. These reference standards are too vague and uncertain to be workable, and do not provide pipelines with assurance that their purchase costs will be allowed.

Because the Notice was silent on all of these points, neither INGAA, its pipeline members, nor any other interested

party had the opportunity to comment as they are entitled to do under Sec. 553 of the Administrative Procedure Act.

IV

INGAA is keenly aware of the Commission's objective, as stated in the Order (p. 3), to assure maintenance of an adequate gas supply for the interstate market. But to shift the burden of rate justification from small producers to pipelines would deter rather than encourage pipelines in seeking out small producers for new supplies.

Under Order No. 428 the burden of justifying exempted small producer rates falls squarely on the pipelines with no protection accorded them against refunds and without any assurance that the prices paid for gas purchased from such producers will be able to measure up to the vague standards which the Commission indicates it will use. The Commission states that the issue will be resolved either in a pipeline rate case or a proceeding involving only the tracking increase. In either event, the standard which the Commission ostensibly would use to determine whether

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the contract rate is "unreasonably high" is to compare the rate with the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Pipelines must not be required to meet this standard at the risk of disallowance of purchased gas costs. Hard evidence of intrastate gas sales prices are almost impossible to obtain, at least by private parties, and, rather, are the subject of rumor, speculation and uncertainty. A pipeline company in need of gas is thus put in the untenable position of having to negotiate with the small producer for gas at a price which may at some date in the future be declared to be unreasonable and thus subject to roll back and refund of uncertain

amounts, depending upon the rate level which the Commission considers to be the maximum which the pipeline should have paid.[2] Moreover, the Commission states that is reserves the right to require a pipeline to file all information required by § 154.63 if it deems such information to be necessary (Ord. p. 9), and further, that in making its determination [on the reasonableness of the small producer rate] it will consider "all relevant factors", citing the decisions of the Supreme Court in *Permian* and the Fifth Circuit Court of Appeals in *Southern*

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Louisiana.[3] As a general proposition such pronouncements may well be appropriate but in the context of this proceeding they raise the grim spectre of producer price regulation imposed at the pipeline level with months, perhaps years of rate uncertainty and the prospect of retroactive ratemaking. Such indirect regulation of producer prices is far beyond the purview of the Act and we submit is an unlawful burden to be placed upon the pipeline companies.

It is INGAA's position that to require refunds from a pipeline because a producer received prices which the Commission subsequently determines to be too high is impermissible under the Act. Even if one were to assume that refunds due solely to small producer rates were lawful, the possibility of pipeline rate reductions due to other unrelated cost factors, which is clearly

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[2]Contrast this uncertain treatment of pipeline gas cost with the Commission's statement, "We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change" (Order No. 428, page 3). No attempt has been made to justify the irrational disparity of treatment between the two parties to the same contract, both of which are subject to the Commission's jurisdiction.

[3]*Area Rate Proceeding (Permain Basin Area)*, 390 U.S. 747 (1968); *Austral Oil Co.* v. *F.P.C.*,______F.2d______ (Fifth Circuit 1970, Slip opinion dated March 19, 1970, No. 27492, *et al.*)

present in the approach the Commission has now fashioned for pipelines in regulating small producers, is manifestly unlawful. The Act does not give the Commission the authority to make reparations or to make retroactive adjustments in rates. Further, tracking rate increases related solely to purchased gas costs cannot and should not be used as a means for reducing a pipeline company's filed effective rate except prospectively within the framework of Section 5 of the Act. *FPC* v. *Hope*

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Natural Gas Company, 320 U.S. 591 (1944); *Montana-Dakota Utilities Co.* v. *Northwest Public Service Co.*, 341 U.S. 246 (1951); *FPC* v. *SunRay DX Oil Company*, 391 U.S. 9, 23-24 (1968).

V

In its Order, the Commission seems to imply that since small producer sales amount to only about ten percent of the total gas purchased by interstate gas pipeline companies, the impact of this regulation will not seriously affect the pipelines. This is not true. For many companies substantial variation in purchased gas costs attributable to small producers could significantly affect earnings and produce rate and financial uncertainty.

In 1968, independent producers domestically sold interstate pipelines a total of 12,214,721 MMcf of natural gas at a cost to the pipelines of $2,101,202,000.[4] Assuming small producers account for ten percent of this amount, it can be seen that this is a sizeable figure. It is not inconceivable that producer prices in the next few years could increase by as much as a third or more, such that the pipelines would be encountering

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[4]Sales by Producers of Natural Gas To Interstate Pipeline Companies, 1968.

purchased gas cost increases from small producers alone of as much as $75,000,000. Despite the urgency of the gas supply situation with which the Commission, the pipelines and all interested persons are properly

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concerned, this is a large sum of money to be paid by pipelines without any real certainty that they can recover the increased costs. It is INGAA's firm belief that the key to finding and committing new reserves to the interstate market is through increased area prices, and that creating price disparity between small and large producers and shifting the rate justification burden from the small producer to the pipeline purchaser can only hinder the efforts to end the supply crisis. Thus INGAA submits that the price paid small producers should bear some relationship to the applicable area rate or guideline ceiling price, particularly where, as here, the *purchasers* are faced with the burden not only of justifying the *seller's* price but also of having to refund those amounts found by the Commission at some later date to be unreasonable. Also, at the very least, the Commission should establish procedures whereby it can obtain and make available to prospective interstate purchasers all pertinent intrastate sales contract price data. See, e.g., Docket No. R-389A, Notice of Investigation, dated July 17, 1970, and letter of Staff dated September 9, 1970, in response thereto, transmitting data gathered on intrastate sales.[5] In this regard it is also urged that the Commission issue an official list of producers who have small producer certificates in order for the pipelines to pay and track accurately

[5]While INGAA does not suggest any particular procedure to be followed, other parties filing may do so. In any case, this matter should be re-noticed so that all interested parties may comment on such procedures and other pertinent matters. (see infra p. 10).

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the resultant increases and that such list be issued no later than 45 days prior to the effectiveness of any small producer exemption.

VI

The pipelines are faced here with the sort of troublesome and unreasonable burdens imposed by the Commission's Purchased Gas Adjustment Provisions in Docket No. R-406, which is now pending before the Commission. Commenting on the provisions proposed there which are similar in many respects to those set forth in Order No. 428, INGAA stated:

> ". . . [T] he pipeline companies under the procedures prescribed here would be faced with the exposure of rate refunds unlimited as to amount and periods for which such refunds could be required. This in turn would lead to uncertainties as to earnings, which would make more difficult an already difficult financing situation where securities are to be issued. A pipeline company would have no definite record or estimate of earnings, it would be unable to determine with any degree of accuracy whether or by how much it was complying with the coverage requirements of earlier debt issues, and it would be precluded from relying upon current earnings in issuing long term debt securities. The ever-present spectre of reparations and retroactive ratemaking would undermine investor confidence and would create an intolerable financial situation for the companies."

The Commission justifies its action in this regard by stating that the regulation of small producer rates through regulation of pipeline rates will be "protective of consumer interest". While protection of the consumer is the primary aim of the Act,

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INGAA believes the consumer has

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just as much at stake as the industry in securing a plentiful supply of gas. It is not unreasonable, therefore, to place some of the risk of small producer non-regulation on the consumer and not all of it on the share-holders of the pipelines as Order No. 428 would do. There should be a sharing of the risk just as there should be a sharing of the benefits.

VII

Order No. 428 would permit tracking increase filings only where small producer rate increases, or such increases together with other increases authorized for tracking, affect the pipeline's cost of purchased gas by one mill or more. This is the same triggering level to which INGAA objected in Docket No. R-406 and the same objection applies here. This amount is excessive for many pipelines and could lead to an unreasonable lag between increased producer costs and the filing of tracking increases. INGAA would urge that a minimum dollar amount be fixed on a company by company basis for activating a tracking increase, tailored to meet the individual company's needs. Alternatively, INGAA would urge that the adjustment amount be reduced to one-tenth mill ($0.0001) per Mcf where the particular pipeline designs its rates to that tolerance.

VIII

As noted previously herein, the Notice of Proposed Rulemaking failed to give any indication that the Commission intended to make the pipelines bear the brunt of small producer regulation. These are matters

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of substance within the meaning of § 553 of the Administrative Procedure Act and should have been set forth in the Notice so that all interested parties would be afforded the opportunity to comment. The Notice was therefore defective and the instant order invalid. *Texaco Inc.* v. *FPC,* 412 F. 2d 740 (CA3, 1969). There the court said (p. 744):

> "Section 553 was enacted to give the public an opportunity to participate in the rule-making process. It also enables the agency promulgating the rule to educate itself before establishing rules and procedures which have a substantial impact on those regulated. See *Pacific Coast European Conference* v. *United States,* 350 F. 2d 197, 205 (9th Cir.), cert. den. 382 U.S. 958 (1965). These procedures must be followed when an agency is exercising its legislative function in order that its rules have the force of law." Citing *NLRB* v. *Wyman,* 394 U.S. 759, 89 S. Ct. 1426 (1969).

Unless the Order herein is rescinded or modified so as to remove the onerous and unlawful burdens on the pipelines, INGAA submits that the pipelines will have been denied the due process of law to which they are entitled under the Constitution, the Act and the Administrative Procedure Act.

CONCLUSION

Wherefore, in consideration of all of the above, INGAA urges the Commission to grant rehearing and that (1) it reconsider and modify its Order No. 428 so as to eliminate the burdensome and unlawful requirements imposed on pipelines purchasing natural gas from small producers or (2) renotice its proposal and set forth with particularity the manner in

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which it would (a) propose to exempt small producers from the provisions of the Act, (b) the extent to which the pipelines would be required to shoulder the regulatory responsibilities of the exempted small producers, and (c) the procedures it would establish to permit tracking increases by pipelines.

Respectfully submitted,

INDEPENDENT NATURAL GAS
ASSOCIATION OF AMERICA

By /s/ Jerome J. McGrath
Jerome J. McGrath
Vice President and General Counsel

Washington, D. C.

April 16, 1971

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CITY OF WASHINGTON)
) SS
DISTRICT OF COLUMBIA)

Jerome J. McGrath, being first duly sworn according to law, says that he is Vice President and General Counsel of Independent Natural Gas Association of America; that he has read the foregoing Application for Rehearing and Reconsideration and is familiar with the contents thereof; and that he has executed same on behalf of said Association with full power and authority to do so.

/s/Jerome J. McGrath

Jerome J. McGrath

Subscribed and sworn to before me, a Notary Public in and for the District of Columbia, this 16th day of April, 1971.

/s/ Etha L. Connor

Notary Public

My Commission Expires:

August 14, 1974

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BEFORE THE

FEDERAL POWER COMMISSION

In the matter of	)	
	)	Docket No. R-393
Exemption of Small Producers	)	
From Regulation	)	

APPLICATION FOR REHEARING
OF
TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC.

Pursuant to Section 19(a) of the Natural Gas Act and Section 1.34 of the Commission's Rules of Practice and Procedure, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee), having previously filed comments in the above-captioned proceeding and being aggrieved by the Commission's Order No. 428 issued herein on March 18, 1971, hereby applies for rehearing with respect to that order.

In said Order No. 428, the Commission undertakes (1) to exempt all existing and future jurisdictional sales made by "small"producers, *i.e.*, producers whose jurisdictional sales do not exceed 10,000,000 Mcf annually, from regulation under the Natural Gas Act and the Commission's regulations thereunder[1] and (2) to substitute, as the means of providing the requisite consumer protection, a vague "market mechanism" standard

[1]Under Order No. 428, such producers would be required only to submit annually a report as to their total volumes of jurisdictional sales during the past year and possibly comply with Section 7(b) of the Act in some situations.

under which the impact of Commission's omission of small producer regulation would be shifted to the pipelines (Order p. 8).

For the reasons set forth below, Tennessee submits that the Commission should grant rehearing and, upon such rehearing, to set aside Order

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No. 428 as arbitrary, capricious, violative of both the Natural Gas Act and the Administrative Procedure Act as well as fatally vague and ambiguous.

I

Order No. 428 sets forth a number of reasons, purportedly in justification for exempting "small" producers from regulation under the Natural Gas Act. However, as shown below, these reasons are unsound, invalid and internally inconsistent.

(a) As its first reason, the Commission asserts (Order p. 3) that the proposed exemption "shall encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas," thereby constituting "an important step forward" in the meeting of the "Commission responsibilit[y] under the Natural Gas Act * * * to assure maintenance of an adequate gas supply for the interstate market."

But, in undertaking to provide to the producers qualifying as small producers incentives over and above those to be provided to the producers not so qualifying, the Commission implicitly assumes that small producers need incentives over and above those to be provided other producers in order to induce them to increase their exploratory efforts. Not only is there

nothing to support that assumption, but there is nothing to support the inclusion in the small producers exemption of all who produce up to 10,000,000 Mcf a year.[2] As a result, the small producer exemption

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actually may operate to undercut the Commission's efforts also to provide incentives to other producers to increase their exploratory efforts. And, since these other producers constitute the larger part of the producing industry, the net effect of the proposed small producer exemption may be to operate as a depressant, rather than a stimulus, upon the needed exploratory activities.

This is particularly so since, contrary to the Commission's apparent assumption, the fact that there is a fixed limit on the annual production permitted in order to qualify for the exemption, might, as a practical matter, result in limiting the volumes of additional gas which such producers would be willing to make available for the interstate markets. Since the exemption, in effect, thus provides an incentive for a producer to remain small, small producers discovering new gas obviously would prefer selling it in the intrastate, rather than the interstate, markets, in order to avoid jeopardizing the exemption, particularly if the producer's production is already nearing the 10,000,000 Mcf level on an annual basis.

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[2] To be sure, the Commission had defined small producers in terms of 10,000,000 Mcf annual production for the purpose of relieving them from certain of the filing requirements under the Act and Commission regulations. See *Permian Basin Area Rate Case*, 34 F.P.C. 159, 234-236. However, inasmuch as the small producer classification in *Permian* was not used in connection with an exemption from Commission rate regulation, as in the instant proceeding, the justification for the classification in *Permian* does not necessarily carry over here.

The proposed exemption would have a depressant effect upon the availability of new gas for the interstate markets in still another way. Order No. 428 provides (p. 6), that

> "the royalty interests stand in the same shoes as the working interest owners. Consequently, if a relates to a small producer sale, such interest shall be exempt, but if it applies to any other sale, it will not be exempt."

Since the effect of this provision is that the royalty payments by small producers would be based on the "market value" nonregulated price whereas

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royalty payments by large producers would be based on the lower regulated price, a landowner would obviously prefer to lease his potential gas-producing properties to small producers, with the results just discussed.

(b) To be sure, the proposed exemption might result in a marked increase in the gas available to the interstate markets if it brought about a proliferation in the number of small producers and such new small producers engaged in successful exploratory activities. But, if it did, it would increase the volume of gas produced by small producers generally and to this extent, undercut the Commission's second reason for exempting them from rate regulation under the Act, *i.e.*, that such exemption would not have a significant impact upon the purchasing pipelines.[3] In this regard, it should be noted that the

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[3]The Commission apparently referred to the pipelines rather than the consuming public since under the substitute regulatory scheme proposed by it, the pipelines are to absorb the costs of any excessive price paid to the small producers through disallowance of such cost in the pipelines' cost of service. See *infra* pp. 9-10.

statistics set out in the Commission's Order patently grossly understate such impact, even assuming that the numbers thus set out are otherwise accurate.[4]

In addition to the fact that the use of averages minimizes the magnitude of small producer sales for a number of pipelines (see *Permian Basin Area Rate Case*, Supra at 235), the statistics used by the Commission admittedly "do not include resales to pieplines by large producers of gas purchased from small producers." (Order p. 3, fn 1) Yet, Order No. 428

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(at p. 5) explicitly provides for such resales to be included within the proposed exemption, and the transcript of the conference held indicates that the volumes involved may well be very substantial. For example, while he could not quantify the volume purchased from small producers, Counsel for Phillips Petroleum Company indicated that between 40 and 50% of its total jurisdictional sales represent purchases from other producers (including small producers) (Tr. 21). Counsel for Signal Oil and Gas Company indicated that Signal has

> "very, very little production of [its] own. Almost 100% is purchased from other producers * * * * * * [I]t looks to us like between 60 and 70 percent of the gas that we sell presently comes from small producers." (Tr. 45-46)

[4]Although the statistics set out in Order No. 428 purport to be based on figures taken from the 1969 Forms 2 and 2-A, the underlying computations by which the statistics are arrived at are not a part of the record and have not otherwise been made available.

sold which would come within the exemption would be substantially greater than indicated by the statistics set forth by the Commission.[5]

In any case, even as adjusted to include such large producer resales, the Commission's statistics would still fall short of reflecting the true impact of the exemption. This is so because (1) the statistics used relate to a period when the proposed exemption was unavailable, and (2) the very purpose of the proposed exemption is to encourage increased exploration, and thereby, to increase the production and sale of gas by small producers in the interstate markets. To the extent that this purpose is achieved and brings about the sought-after increase in small producer sales, the result would be an increased impact upon the pipelines. Plainly, therefore, the statistics

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relied on by the Commission do not provide any measure of the impact of the proposed exemption upon the pipelines and further proceedings are obviously in order before any meaningful determination of that impact could be made.

(c) The Commission's final reason, *i.e.*, that the exemption would "relieve the small producer of the expenses and burdens relating to regulatory matters" (Order p. 3) loses much of its force when it is remembered that the Commission has already relieved the small producers in the Permian Basin and Southern Louisiana areas from the need to file certificate and rate applications as long as the rates charged do not exceed the applicable area rates. See 34 FPC 434, Sec. 157.40 of the Commission's Rules and Regulations. Extension of these provisions

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[5]The nature of the underlying rulemaking proceeding and the lack of an evidentiary record makes it impossible to ascertain the full thrust of the proposed exemption.

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to other areas would appear to be sufficient without more to relieve the small producers of the expenses and burdens relating to regulation.

II

Since the effect of exempting the small producers from the rate regulatory provisions of the Natural Gas Act provided in Order No. 428 is to enable such producers to collect prices in excess of the applicable area rates or guideline rates, Order No. 428 has sought to provide substitute safeguards in order to insulate the consuming public from the unreasonably high small producer prices which might result. These substitute safeguards are in the form of imposing the responsibility upon the pipelines of guarding against contracting to pay excessive prices to the small producers on penalty of suffering disallowance of the excessive portion from their cost of service.

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Such substitute regulatory scheme not only departs improperly from that provided by Congress in the Natural Gas Act, but, without warrant, imposes the burdens of small producer regulation and the resulting uncertainties and exposures to potential disallowances of costs upon the pipelines. And, since there is nothing in the Commission's Notice of Proposed Rulemaking dated July 23 1970, indicating any intention to impose these burdens upon the pipelines, Order No. 428's imposition of such burdens upon the pipelines violates Section 3 of the Administrative Procedure Act (5 U.S.C. 551, 553).

(a) It has been established since the Supreme Court decided the first *Phillips* case (*Phillips Petroleum Company* v. *State of Wisconsin,* 347 U.S. 672) in 1954, that the Natural Gas Act vest in the *Commission* the responsibility for regulating the rates for *all* wholesale sales of natural gas in interstate

commerce, regardless of the classification (pipeline or producer) or size (large or small) of the seller. See also *Deep South Oil Company of Texas* v. *F.P.C.*, 247 fF.2d 882, 884, 887 (5th Cir. 1957) (holding the sales of natural gas by "a small unintegrated corporation engaged in the exploration for and the production of oil and gas" to be subject to regulation under the Act); *Saturn Oil & Gas Co.* v. *F.P.C.* 250 F. 2d 61, 66-67 (10th Cir. 1958).

The Commission purports to find the requisite power to waive its admitted jurisdiction in *F.P.C.* v. *Hunt*, 376 U.S. 515 (1964) and *Permian Basin Area Rate Case*, 390 U.S. 747 (1968). But neither of these cases support the Commission's position. The *Hunt* case involved the question of the Commission's power to condition a temporary certificate upon the

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maintenance of a prescribed price during the period of temporary authorization; the comment of Mr. Justice Clark (376 U.S. at 527) relied on by the Commission here thus is pure dictum and the reference to the National Labor Relations Board suffers from the infirmity that it relates to an entirely different type of situation.[8]

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[8]In *Hunt* and his dissent in the second *Phillips* case (*State of Wisconsin* v. *F.P.C.*, 373 U.S. 294, 328-330 (1963)), Mr. Justice Clark suggested that the Commission look to the National Labor Relations Board for a method of handling exemptions. However, in addition to the fact that the National Labor Relations Act vests discretion in the Board whether to exercise its jurisdiction (see 29 U.S.C. 160(a)), the effect of such a Board waiver is to cede jurisdiction to a state and territorial agency. Here, in contrast, there is neither express authority in the Commission to waive jurisdiction nor does a local agency exist with power to regulate small producer sales of natural gas for resale in interstate commerce in the event of such a waiver. Indeed, the existence of such a local body would be at odds with the purpose of the Commission's action here, which is to free small producer sales from *all* direct regulation.

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Moreover, while the Supreme Court in *Permian* approved the special small producers provisions there prescribed by the Commission, these special provisions plainly did not extend to exempting these producers from area prices. To the contrary, the Commission there expressed strong doubts whether it had the authority to provide such an exemption, stating (34 F.P.C. at 234):

> "While we are convinced that there is a need for distinctive treatment for small producers . . . we do not believe it is necessary or desirable to provide outright exemption. We reach this conclusion assuming that exemption is legally permissible despite the mandatory language of Sections 4 and 7 of the Natural Gas Act.[49]

[49] Section 4(a) states in part that "*all* rates and charges" by "any natural gas company shall be just and resonable." In Section 4(c) it is stated that "under such rules and regulations as the Commission may prescribe, *every* natural gas company shall file . . . . in such form as the Commission may designate, . . . *all* rates and changes . . ."

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Section 7(c) provides in part that "No natural gas company . . . shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity . . ." (emphasis in original)

Plainly, in these circumstances, the Supreme Court's affirmance in *Permian* of power in the Commission to exempt small producers from various filing requirements does not extend to the exemption of such producers entirely from the rate regulation provision of the Natural Gas Act, a provision which has been characterized as "the heart of the * * * regulatory system," *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 491, 611 (1944).

(b) Even if it be assumed *arguendo* that the Act vests discretion in the Commission whether to exercise jurisdiction over the small producers, there is nothing in the Act–and Order No. 428 contains no citation of authority–indicating any power in the Commission to shift the Commission's responsibilities to the pipelines and to require them to bear the costs, risks and uncertainties of assuring that the Commission's exemption does not redound to the detriment of the consumers. In other words, there is nothing in the Natural Gas Act authorizing the Commission (1) to shift its regulatory responsibilities with regard to small producers to the pipelines, subject to *post facto*, Commission "second guessing" and (2) to make the pipelines, rather than the small producers, bear losses which would result from a Commission determination upon such *post facto* review that a portion of the contract price should be disallowed as excessive.

While the Commission has authority in appropriate situations to inquire into the reasonableness of a pipeline's operating expenses and to disallow those items of costs found to be imprudent, such authority does

not extend to the cost of purchased gas. Rather, it extends at most only to those items of operating expense as to which the Commission has not been given direct regulatory authority. In contrast, the cost of purchased gas is the major item of expense in operating a pipeline system as compared to the other costs which are merely incidental thereto. Moreover, and more important in this regard, the Natural Gas Act specifically designates the Commission as the body responsible for regulating the prices at which such gas is sold for resale in interstate commerce. In addition, by focussing the jurisdictional impact upon the activities of the seller, Congress clearly intended that the burden of any excessive rates be borne by the seller, not the purchaser. In these circumstances, the Commission clearly has no power to discard this Congressionally prescribed scheme for regulating producer rates in favor of a "market mechanism" which shifts the burdens of consumer protection from those specifically designated by Congress to the pipelines.

(c) Particularly unjustified and unlawful is the Commission's attempt so to shift these Congressionally prescribed responsibilities to the pipelines with respect to the small producer contracts already in existence when Order No. 428 was issued. Since these contracts were entered into prior to the issuance of Order No. 428, and, in most instances, prior to the issuance of the Notice of Rulemaking culminating in the issuance of that Order, the pipelines could not have been on notice at the time they entered into these contracts that the existing regulatory scheme was about to be changed. In these circumstances, now to shift the responsibilities and to require the pipelines to bear the costs resulting from the disallowance

as excessive of a portion of the contract price agreed upon prior to the issuance of Order No. 428, is tantamount to unlawful confiscation of property.

(d) Further compounding the Commission's error in this regard is vagueness and lack of certainty as the the standards to be applied by the Commission in determining whether the prices which a pipeline contracted to pay a small producer is excessive. Such certainty is required in order that a pipeline may make an informed evaluation of the exposures attaching to a proposed small producer gas sales contract before deciding whether to go ahead with the proposed contract.

To be sure, Order No. 428 (at p. 8) provides that pipeline rates will be subject to reduction and refund "with respect to new small producer sales * * * as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market prices for intrastate sales in the same producing area." But the "standards" thus provided are wholly vague and lacking in certainty.

To begin with, Order No. 428 is vague as to the applicability of the standards there provided by the Commission. While there appears to be no question but that the "standards" are to apply to "*new* small producer sales," it is unclear whether they also are intended to apply to prices paid by the pipelines under their *existing* small producer contracts. As indicated above, the only reference to these standards is in the context of *new* producer sales. Should the Commission intend that these "standards" not apply to exising small producer sales, then there is a complete absence from Order No. 428 of any reference to the standards to be applied with

reference to such existing sales. Indeed, it is even unclear whether the phrase, "new small producer sales," is intended to include a contract made to replace an expired one. Is such a contract to be considered a "new contract" for these purposes?

Further ambiguity arises from the provision that the determination of whether a rate is "unreasonably high" is to be made by "considering appropriate comparisons with," etc. What does "considering appropriate comparisons" mean? Does it mean that the "standards" thereafter listed are merely to be taken into account without having controlling effect? And, if so, does it mean that factors in addition to those listed are merely to be taken into account without having controlling effect? And, if so, does it mean that factors in addition to those listed are to be considered in making the "appropriate comparisons?" If the latter, then what are the additional factors, and what weight is to be given to these additional factors as against those specifically listed?

Assuming that only the factors specifically listed are to be considered in making the "appropriate comparisons," then it is unclear, since there are two "standards" listed, whether both are to be taken into account in making the determination, or only one. The ambiguity in this regard is accentuated by the use of the disjunctive "or." Suppose, for example, that "the highest contract price for sales by large producers" is found to be different–higher or lower–from "the prevailing market prices for intrastate sales in the same producing area." Is one to be controlling and if so, which one? If neither is controlling and both are to be taken into account, what is the weight to be given each?

Turning now to the "standards" themselves, what is meant by "the highest contract prices for sales by large producers?" Does the phrase "sales by large producers" include intrastate

sales as well as interstate sales? Nonjurisdictional direct sales as well as jurisdictional sales for

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resale? Does the phrase "the highest contract prices" include the highest contract price even if not paid or is it limited to the highest contract price actually paid? Does the phrase include more than one highest contract price, and if so, how are they to be used in making the "appropriate comparisons?" Suppose that the highest prices in a producing area turn out to be 29¢ and 30¢ per Mcf. Which price, if either, would be controlling? And how would the "appropriate comparisons" be made in these circumstances?

The second "standard," *i.e.*, "the prevailing market price for intrastate sales in the same producing area," similarly suffers from vagueness. What is meant by "prevailing market price?" Does it mean the current price at which new contract are being executed or the prices being paid under existing contracts? As to "market price," which price does it refer to if there are a number of sales at different prices? The highest, the lowest, the median, the average, weighted or unweighted?[9] Finally, what does "same producing area" include, the field from which the gas is produced or an area such as that used by the Commission in determining area prices are something in between?

Thus, these "standards" are so vague and ambigous as to not even provide a minimum of guidance as to whether a pipeline should or should not contract with a small producer.

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[9] Assuming, of course, that such information would be available to a pipeline which is negotiating a gas purchase contract with a small producer.

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III

By its order, the Commission purports to waive Section 154.63 of its Regulations to permit pipelines to "file rate increase applications to track small producer rate increases resulting from the exemption," provided that such small producer increases (combined with other increases authorized for tracking by unspecified Commission orders) "affect the pipeline's average cost of purchased gas by one mill or more."

(a) The Commission's Notice of Rulemaking did not propose a one mill triggering level as a condition to pipeline tracking of small producer increases. On the contrary, the Notice indicated that there would be *no* such triggering level. The Commission's order is, therefore, a wholly unlawful disregard of the notice requirements for rulemaking under Section 553 of the Administrative Procedure Act.[10] Not having given interested parties an opportunity to comment prior to the imposition of the one mill standard, the Commission cannot now lawfully or fairly impose that limitation upon Tennessee, now faced with a *surge* of increases attributable directly to the Commission's order.

(b) The one mill standard is demonstrably and unreasonably excessive, and unlawfully discriminates against the larger pipelines. For example, before Tennessee could "track" the effect of the Commission's

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[10] It should also be noted that no triggering level is imposed upon large producers as condition to their filing for increased rates to reflect the effect of the exemption. The Commission's order thus unlawfully and unduly discriminates against pipelines, and, in effect, casts the entire burden of the small producer exemption upon the pipelines to the extent that increases, as a result of the exemption, do not "affect" a one-mill increase in a pipeline's average cost of gas.

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order, it will have to absorb all small producer increases until it experiences an overall annual increase of approximately $1,200,000 in its purchased gas costs. Clearly, it is unreasonable to establish a standard which so forecloses a pipeline from securing timely and meaningful rate relief.

(c) The unreasonableness of the one-mill standard is further compounded by the fact, that under the procedures established by the Commission's order, small producer increases will not all become effective within a definite or known period of time. Rather, such increases will have to be paid by the pipelines in dribs and dabs as individual small producers sporadically file for and receive their exemptions. Thus, the larger pipelines, such as Tennessee, may have to absorb the various increases that do occur for a considerable period of time before all of the increases ultimately "affect" a one-mill increase in their average purchased gas costs.

(d) Order No. 428 also "reserves the right" to require any pipeline which files to track the small producer increases "to file *all* information" required by Section 154.63 of the Regulations. The earlier "waiver" of the requirements of those Regulations is thus qualified to impose upon the pipeline, at the Commission's election, and, apparently, at any time after a tracking filing is made, the burden of a full Section 4 showing, although the pipeline has only sought to reflect a change in cost of its gas purchases attributable to the small producer increases. Thus, each time a pipeline may seek to track small producer

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increases, it will be faced with a threat of, perhaps, years of rate uncertainty and instability because of the possibility that the Commission will utilize the opportunity to shift the evidentiary burden of proof under Section 5 of the Natural Gas Act to the

pipeline. The threat that such a procedure may be invoked is wholly unreasonable and unfair.

IV

Order No. 428 is unclear with respect to the need for a small producer to file an application under Section 7(b) in order to abandon service. On the one hand, the text of the order states (on p. 7):

> "We think it important to retain control over all abandonments of jurisdictional sales. For this reason, small producers should be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein.[4] We shall also require purchasers to notify us of the cessation of deliveries by a small producer regulated by the terms of this order within 60 days of such cessation."

Yet, on the other hand, the footnote to this statement contains the following comment (fn 4, p. 7):

> "If a contract for an exempted sale expires and is not excluded or replaced by a new contract, the small producer must continue the sale of such gas unless the pipeline consents to abandonment or the producer obtains abandonment authorization."

The inconsistencies between the text and the footnote, coupled with what is left unsaid, leaves unsettled the answers to many problems with respect to abandonment which are likely to arise under the proposed exemption.

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To begin with, the order leaves up in the air as to the

requirements for abandonment prior to the expiration of the contract; do the requirements of Section 7(b) continue to apply with full force prior to the expiration of the contract? And what is the situation with regard to Section 7(b) after the expiration of the contract? Suppose, in such circumstances, the pipeline consents to abandonment, is the small producer still required to seek abandonment authorization? If not, then is the pipeline's notification to the Commission "of the cessation of deliveries by a small producer" intended as a substitute for an abandonment application by the producer? Again, suppose that a pipeline refuses to "consent to an abandonment." Is the small producer then required to file an abandonment application?

Inasmuch as the portion of Order No. 428 dealing with abandonment talks in terms of a pipeline being the purchaser, the question comes up as to what is required as to abandonment when the purchaser is a large producer. Did the Commission intend that the requirements set forth when the purchaser is a pipeline should also apply when the purchaser is a large producer and, if not, then what requirements did the Commission intend to be applicable as to abandonment when the purchaser is a large producer?

Finally, since Order No. 428 would relieve the small producers of the obligation to file separate certificate applications with respect to each new sale, the question arises as to the requirements with regard to abandonment when the new gas sales contract is for a term of, say, two years, five years, ten years? Had the small producer been called upon to file a separate certificate application for each sale, in some

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instances of short term contracts he might have received a certificate of limited duration. Despite this, is it to be assumed in each instance that the obligation with respect to each new gas sale is for an indefinite period regardless of the term provided in

the contract? Or was it the Commission's intention in such circumstances that the small producer's obligation to deliver be only co-extensive under the term of the contract so that upon the expiration of the contract, it is to be presumed that the purchaser had given his "consent to abandonment" when he entered into the agreement and no further consent is required?

V

Order No. 428 wholly ignores the effect of small producer exemptions on currently effective procedures under which pipelines are charged and pay for the volumes which are delivered from various fields or gas producing units. Specific questions on this point were raised in Tennessee's comments, and again during the informal conference (Tr. 8, 13-14) because of the potential liability in the event payments are made based on erroneous billing submitted by a small producer, or by a large producer on behalf of the small working-interest owners.

(a) In *many* instances jurisdictional sales of natural gas may be made by producers, although the purchasing pipeline has *no contractual relationship* with the owner of the natural gas. Such situations arise primarily when a plant or property operator delivers

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natural gas under a contract with a pipeline, but for one reason or another, that contract has *not been executed* by other working-interest co-owners of the gas. This is generally known as a "non-signatory co-owner" sale under the existing Regulations [See Section 159.91(d) and (e)].

Under Order No. 428, volumes sold to the pipelines which are owned by a "small" non-signatory co-owner are exempted from further rate regulation. The question thus posed is, on what basis shall the pipeline be required to pay for volumes

attributable to non-signatory working-interest owners who qualify as small producers.[12] Under present regulations, such non-signatory co-owner volumes are covered by the operators' rate schedule and its filed rate because non-signatories may not file certificate applications, rate schedules or rate changes. The operator, in turn, bills for *all* volumes at its filed rate level. Clearly, if a pipeline pays on the basis of the large producer's billing at the filed rate level, it should not be subjected to claims at some later date that the small non-signatory co-owners were entitled to some higher rate, thus exposing the pipeline to the risk of retroactive increases.

(b) The other side of the problem is a situation where the operator of a producing property is a small producer, and the

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non-signatory co-owners (with aggregate working interest in excess of 12½ percent) do not qualify as small producers. In other words, a large producer's volumes are sold under the small producer's rate schedule, since there is no contract between the large producer and the purchasing pipeline. Under Order No. 428 (p. 16), a large producer in such a situation *"may"* (but is not required to) "file rate schedules, rate changes or certificate applications with respect to such interests * * *." The Commission should clearly specify (1) the pipeline's obligation if the "large" producer in that situation does not make the necessary filings; (2) the nature of the filings to be made by the large co-owner producer since there is no contract between him and the purchasing pipeline; and (3) the pipeline's obligations pending the Commission's acceptance of the filings which "may" be

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[12] Order No. 428 (p. 15, paragraph 5) provides that a large producer may file for the price specified in its contract for the *resale* of gas *sold* to it by a small producer. Under the "non-signatory co-owner" situation, there is no "*sale*" to the large producer by the small non-signatory co-owner, and, hence, there is no *resale* to which the large producer's filing can relate.

tendered by the large producer.

(c) Order No. 428 provides that small producers who have applied for small producer certificates are to be entitled to the exemption and such higher rates as may be applicable "as of 45 days from the date" of Order No. 428. This is plainly an illegal procedure since it would operate to provide a basis for small producers to claim retroactive increases in rates for sales to the pipeline purchasers, depending on when the Commission acts on the pending applications. The illegality is further aggravated by the fact that many "small" producers have not seen fit to serve Tennessee with their

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certificate applications for small producer status.[13]

Order No. 428 further provides that those producers which file applications for small producer certificates within 45 days of Order No. 428 will be entitled, upon issuanace of a certificate "regardless of the date of issuance of such certificate," to its small producer status "effective as of 45 days" from the date of the order. This, again, is a plainly illegal procedure designed to provide a basis for small producers to claim retroactive rate increases. For example, the Commission may not act on a pending small producer application for six months.

[13]The Commission's orders issuing small producer certificates have also consistently failed to indicate the purchasers. Thus, Tennessee in many instances has not had notice of either that small producer applications are pending, or that a producer had qualified for that status and received its small producer certificate. Tennessee may not have been served because it did not purchase gas from the particular producer in the area covered by the application. For example, under Order No. 428, a small producer's certificate covering Permian Basin sales, where Tennessee does not purchase, would now be applicable to sales to Tennessee by that same producer in other areas where Tennessee is a purchaser.

Under Order No. 428, the pipeline purchaser would be subject to the small producer's claim for an increase in rate to the contract level for the entire period, although a lower rate was in effect under its filed rate schedule.

Finally, the retroactive application of small producer certificate orders is also unfair and inequitable in that there is no way in which the pipeline can "track" retroactively the effect of the retroactively-imposed obligations.

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VI

In addition to the foregoing, the following problems are also involved in Order No. 428:

(a) At pages 4 and 14 of the order, the Commission provides that the exemption will not apply to a small producer jurisdictional sale where the gas reserves related thereto "were acquired by the *purchase* of developed reserves in place from a large producer." The Commission should clarify the scope of the word "purchase." For example, should a small producer acquire reserves from a large producer by means other than a "purchase," (gift, devise, "swap," etc.) would the small producer exemption apply to a subsequent jurisdictional sale?

(b) The meaning of the word "developed" as used in the above restriction is unclear. For example, one well may be sufficient to indicate "developed" reserves in some areas, while many wells may be required in other areas.

(c) Also unclear is whether small producers, as assignees of interests in a large producer's gas producing properties covered by certificated rate schedules, are to comply with Sections

154.92(d)(1)(2)(3) and 157.24 of Regulations which provide for filings by the assignees for authority to continue a sale from properties which are dedicated to a pipeline purchaser.

(d) It is unclear (1) whether the filing for a "separate certificate authorization" by a small producer to cover a jurisdictional

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sale of gas acquired from a large producer will be necessary if the sale from the properties has already been certificated, and (2) whether it is intended that the Commission's rate regulations apply to the sale.

(e) Assuming that a given "developed" reserve sale transaction from a small producer to a large producer is non-jurisdictional, the economic effect of such a transaction would appear to force the ultimate sale of such reserves by the large producer to a non-regulated market. This is because of the need that the large producer secure a price sufficient to recover the payment made to the small producer, plus its necessary profit margin. The Commission should indicate the effect it anticipates in such situations as to the ultimate availablity of gas to the interstate market.

(f) It is unclear whether, when a small producer sells dedicated "developed" reserves in place to a large producer, the large producer will be required to sell at a regulated price, rather than the previously effective exempt price. If the large producer must sell at a *lesser* regulated price, the Commission should indicate the economic effect that such a result would have on future lease trades, sales, *etc.*, between small and large producers in terms of further development of new reserves for commitment to the interstate market.

(g) The Commission should specify whether small producer warranty-type or spots sales involving no particular reserve dedication would be exempt if the reserves actually used for such sales were acquired in part from a large producer.

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(h) Under Order No. 428, a small producer owning a gas reserve jointly with a large producer could commence sale without specific certificate authorization long before the large producer could obtain certificate authority from the Commission. It is unclear whether it would be permissible for the large producer's interest (assuming an interest in excess of 12½ percent) to be sold under the small producer's contract pending Commission determinations respecting the large producer's certificate application.

(i) It is unclear whether small producers will be governed by the outcome of the AR61-2, AR69-1, *Southern Louisiana* area proceeding as to refund liabilities, particularly if the UDC settlement proposal is adopted.

(j) It is unclear, particularly in view of the findings at page 4 of the order, whether large producers are to be permitted to use "flexible" pricing clauses in their contracts, other than those allowed by Section 154.93 of Regulations, in order to reflect small producer increases.

(k) It is unclear whether large producers will be entitled to file rate changes in excess of contract levels in order to reflect small producer increases without first securing Commission authorization under Section 5 of the Natural Gas Act.

(l) Order No. 428 contains no showing of the factual and legal basis under *Mobile* (350 U.S. 332) and *Sierra* (350 U.S. 348) standards for the predetermination in the footnote on page 9 that small producers may

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"file for" the "minimum" rate authorized in any area.

(m) The requirement that pipelines file all "new" contracts, contract amendments, and notices of cessation of deliveries relating to small producer sales is improper and unlawful. There is nothing in the Notice of Proposed Rulemaking that such filing requirements would be imposed upon the pipelines. Moreover, the filing requirements are contrary to the provision of Section 4 and Section 7 of the Natural Gas Act, relating to the Commission's authority to require filings and applications by "natural gas companies."

(n) There is no indication in Order No. 428 as to the basis upon which the Commission intends to ascertain the "prevailing price differential in the area" in determining the propriety of "large" producer increases.

WHEREFORE, for the foregoing reasons, it is respectfully submitted that the Commission should grant rehearing with respect to Order No. 428 issued in the above proceeding on March 18, 1971 and, upon such rehearing, to vacate that order.

Respectfully submitted,

TENNESSEE GAS PIPELINE COMPANY,
A DUVISION OF TENNECO INC.

By /s/ Melvin Richter

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April 16, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

EXEMPTION OF SMALL PRODUCERS)
FROM REGULATIONS) Docket No. R-393

APPLICATION OF WARREN PETROLEUM CORPORATION
FOR REHEARING AND RECONSIDERATION
OF ORDER NO. 428

Now comes Warren Petroleum Corporation (Warren) and, pursuant to Section 19(a) of the Natural Gas Act and Section 1.34 of the Commission's Rules of Practice and Procedure, and files this application for rehearing and reconsideration of Order No. 428 issued by the Commission in the above docket on March 18, 1971.

The person upon whom service of pleadings, documents or communications with respect to this matter should be made is as follows:

Warren M. Sparks
Warren Petroleum Corporation
P.O. Box 1589
Tulsa, Oklahoma 74102

In support of this application, Warren would show the following:

I.

By Notice of Proposed Rulemaking issued on July 23, 1970 in Docket No. R-393, the Commission proposed to exempt from regulation and under the Natural Gas Act all existing and all future jurisdictional sales made by small producers. Small producers were defined for this purpose as being producers whose jurisdictional sales on a nationwide basis,

together with such sales of affiliate producers, are not in excess of 10,000,000 Mcf in a calendar year, exclusive of sales made pursuant to percentage sales contracts. Under the Commission proposal as noticed, the small producer could file for a blanket certificate which would exempt the small producer from

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all provisions of the Natural Gas Act and the Commission's Regulations, otherwise applicable to jurisdictional sales covered by such exemptions, except for the requirement that the small producer submit annually a document setting forth its volume of jurisdictional sales. Although the Commission's Notice indicated that the proposed exemption for small producers would include, *inter alia*, jurisdictional sales made by small producers to a large producer, and that the resale of such gas by the large producer, would remain subject to Commission jurisdiction, it did not indicate that large producers would be required to take the risk of their contract differential being consistent with "prevailing price differentials in the area" and of the small producer price not being "unreasonably high." The Commission's Notice is fatally defective because it did not indicate that Warren, as a large producer, would have to bear these risks of subsequent Commission action rejecting its contract prices with small producers without recourse to reimbursement from the small producers by way of refunds. Warren did not file comments on this proposal as noticed, believing none were required, but hereby submits that Order No. 428 went beyond the scope of the rulemaking notice to the detriment of Warren, and that rehearing or reconsideration of this order should be granted.

II.

Without regard to the sufficiency of the Notice, the Commission's exemption of the small producer from price regulation, while at the same time imposing on Warren as a large producer the risk of the Commission's rejection of the price to be paid the small producer, is beyond the power of the

Commission under the Natural Gas Act. If the Commission is going to permit the small producer to exact his contract price from a large producer free of Commission regulation, the Commission cannot deny the large producer the

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right to pass on his higher cost to his purchaser. The Order, as written, is unreasonably discriminatory and preferential as between large and small producers and is in violation of Section 4 of the Natural Gas Act.

III.

Warren, as a large producer, will be faced with the further problem of purchasing gas which must be resold under old contracts which contain prices that are not competitive with the existing market values. Many old contracts obligate the large producer to deliver any new gas he may purchase at the price in the old contract. In such instances, a large producer will either be limited in what it can pay to the non-competitive prices in a contract executed many years before, or will have to absorb the loss. The only other alternative would be to leave existing facilities (processing plant) half used and build new ones that can command a new competitive price. Order No. 428 recognizes the desirability, if not the necessity of according nondiscriminatory treatment to pipelines and large producers with respect to the purchase of gas from small producers. However, the Order, as written, places a large producer at a distinct disadvantage since a pipeline is not limited in the price it can pay by its sales contract and may negotiate any price at the risk only of such price being found to be unreasonably high. This aspect of the Order is unreasonably discriminatory against the large producer. This discrimination would be eliminated by permitting the large producer to pass on his additional cost and maintain his sales margin, regardless of contract limitations.

WHEREFORE, in consideration of the above, Warren urges the Commission to grant rehearing and that it modify Order No. 428 so as to eliminate the errors and inequities which

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will occur as a result of the

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exemption of small producers in the manner prescribed by the order.

Respectfully submitted,

/s/ Warren M. Sparks
Warren M. Sparks
Attorney for
Warren Petroleum Corporation

April 13, 1971

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

Exemption of Small Producers	)	
From Regulation	)	Docket No. R-393

APPLICATION OF CONSOLIDATED GAS SUPPLY CORPORATION FOR REHEARING, RECONSIDERATION AND MODIFICATION

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Filed: April 19, 1971

*Designated, pursuant to FPC Order No. 424, to receive service. It would also be appreciated if service might be made on Henry P. Sullivan.

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

Exemption of Small Producers From Regulation	))	Docket No. R-393

APPLICATION OF CONSOLIDATED GAS SUPPLY CORPORATION FOR REHEARING, RECONSIDERATION AND MODIFICATION

Consolidated Gas Supply Corporation (Consolidated Supply), being aggrieved by the Commission's Order No. 428 issued herein on March 18, 1971, as amended and supplemented by its Order No. 428-A issued on April 9, 1971, hereby files its Application for Rehearing, Reconsideration and Modification, pursuant to Section 19 of the Natural Gas Act (15 U.S.C. 717r) and Section 1.34 of the Commission's Rules of Practice and Procedure (18 CFR 1.34). In support hereof, Consolidated Supply shows the following:

I

Consolidated Supply is an operating subsidiary of Consolidated Natural Gas Company, a registered public utility holding company, and is a natural gas company within the meaning of the Natural Gas Act, subject to the Commission's jurisdiction thereunder. Consolidated Supply and its affiliates comprise the Consolidated Natural Gas System, which serves market areas in New York, Ohio, Pennsylvania and West Virginia. Consolidated Supply, which is the principal supply arm of the Consolidated System, depends for a relatively small but, nonetheless, substantial and critically-important portion of its gas supplies

upon contracts with small producers, as defined in the Regulations promulgated by Order No. 428, particularly in the Appalachian Area.

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Consolidated Supply, having a vital interest in the rulemaking involved herein, on September 15, 1970, filed its Comments and Recommendations in response to the Commission's Notice of Proposed Rulemaking dated July 23, 1970, and actively participated in the conference held on December 8, 1970, in this proceeding, urging that the regulations proposed be modified as follows:

First: Small producers should be exempt from certificate and rate regulations only to the extent that their small-producer sales are made at rates not in excess of applicable ceiling guideline rates or just and reasonable area rates, if the latter have been determined for the area, subject to a provision for petitioning for amendment or waiver permitting higher prices, as suggested in the Commission's Notice of Proposed Rulemaking issued October 16, 1969, and later provided for by the Commission's Order No. 411, as amended by Order No. 411-A, issued October 2 and 30, 1970, in Docket No. R-371, prescribing area rates for the Appalachian and Illinois Basin Areas;

Second: Small producers should be exempt from compliance with Section 7(b) of the Natural Gas Act with respect to the abandonment of their small-producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment; and,

Third: Annual statements by small producers should be expanded to show (in addition to the volumes of annual sales) by areas and jurisdictional purchasers the volumes sold and the prices charged (including what part, if any, constituted production or severance tax reimbursement).

II

The third suggestion above was adopted, in effect, by the Commission's Orders Nos. 428 and 428-A herein. As to the second suggestion, the Commission, in Order No. 428, indicated its intent to retain control over all abandonments,

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yet left in effect Section 157.39 of its Regulations which exempts small producers from its abandonment regulations altogether.

The first suggestion was, for all practical purposes, rejected by the Commission in Order No. 428. Therein, the Commission provided for issuance of blanket certificates to small producers under which they are authorized to make sales nationwide pursuant to existing and future contracts at the prices specified in each such contract with a limited exception, namely, contracts containing favored-nation, price-redetermination and spiral-escalation clauses. The filing of contracts containing such clauses executed on or after April 2, 1962, has been proscribed (Order No. 242, 27 FPC 339); however, the Commission, in Order No. 428 herein, now provides that the clauses may be used to the extent the resulting rate does not exceed the applicable area just and reasonable rate ceiling, or, where none is available, the applicable area guideline initial rate ceiling.

Additionally, without any notice, the Commission surprisingly provides that sales by small producers, from and after May 2, 1971, will be regulated at the pipeline level by the Commission's reviewing the purchased gas costs of each pipeline with respect to small-producer sales. As the Commission, in Order No. 428, states (p. 8):

> "Small producers will have no refund obligations with respect to increased rates, if any, collected for

sales regulated hereunder to pipelines, and, as a result, pipelines will receive no refunds from small producers to flow through. However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in

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(1) a pipeline rate case or (2) a proceeding involving only the tracking increase. Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. The Commission shall consider all relevant factors. See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Austral Oil Co.* v. *F.P.C.*,______F.2d______ (Fifth Circuit 1970, slip opinion dated March 19, 1970, No. 27492, *et al.*) In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests."

III

The Commission erred in adopting and issuing Order No. 428 of March 18, 1971, as amended and supplemented by Order No. 428-A of April 9, 1971, in that the findings, conclusions and ordering provisions thereof are contrary to law, as they fail to meet the requirements of the Natural Gas and

Administrative Procedure Acts (15 U.S.C. 717-717w; 5 U.S.C. 551-559; 701-706) or the Constitution of the United States.

The Commission erred in the particulars and for the reasons stated in "Application for Rehearing and Reconsideration of Independent Natural Gas Association of America", filed herein substantially concurrently herewith. All of the specifications of error and supporting reasons stated therein are relied upon by Consolidated Supply and the same are hereby incorporated herein by reference and made a part hereof.

Briefly stated, contrary to the plain statutory mandate contained in Section 4(a) of the Natural Gas Act, the Commission erred in Order No. 428 by not requiring that small producers should be exempt only to the extent that their sales are made at rates not in excess of applicable ceiling guideline or just and reasonable area rates, as set forth in Consolidated Supply's first suggestion above. Order No. 428, in effect, purports to license small producers to demand and charge rates higher than "just and reasonable" area rates, to wit, rates declared unlawful by Section 4(a) of the Act.

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Moreover, by requiring that pipeline company rates shall be subject to reduction and refund insofar as the prices paid to small producers exceed "the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area", the Commission has, in effect, unfairly and unlawfully shifted the burden of determining just and reasonable rates to be paid small producers to the pipeline companies. To add to the pipeline companies' dilemma, the Commission has not specified whether the highest price paid to large producers *or* the prevailing intrastate price is to fix the ceiling rate which pipeline companies may safely pay, nor has the Commission attempted to define such crucial terms as "prevailing market price" or "producing area".

In short, it appears that, while pipeline companies, in this time of a nationwide gas shortage, must compete vigorously for all available gas supplies, they must not compete too vigorously for fear that their stockholders will be penalized to an indeterminable degree in future rate proceedings through the Commission's disallowance of costs incurred by such companies in their efforts to meet their market requirements.

Certainly, in order to satisfy minimum due process requirements, the Commission must specify with a reasonable degree of clarity the prices which pipeline companies can safely pay for gas purchased from small producers.

IV

Aside from the legality and fairness aspects of Order No. 428, why did the Commission abandon the course of action promulgated by its Order No. 411 issued October 2, 1970, in Docket No. R-371? In that Order, the Commission considered whether contract prices governed by market forces should be relied upon to

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determine area rates in the Appalchian and Illinois Basin Areas, where the great preponderance of sales are by small producers, and concluded that it was not appropriate to do so. In that Order, as amended by Order No. 411-A, the Commission issued certificates to small producers in such Areas without the necessity of rate or certificate filings, with the proviso that any such producer seeking rates higher than the just and reasonable area rates prescribed by the Order must petition for appropriate relief.

It is to be noted that the then newly-promulgated Regulations, to wit, Subsections 157.40(e) and (f), which issued these certificates to the small producers in these two Areas, have been

replaced, and thus repealed, by the instant Order No. 428, without any notice, acknowledgment or explanation.

Order No. 411, in Docket No. R-371, relieved the Commission and the industry of a multitude of filings and burdensome paperwork but, at the same time, defined and limited the prices to be charged by small producers. Now, the instant Order No. 428, without any reference to or acknowledgment of Order No. 411, changes without explanation the well-founded course embarked upon in that earlier Order.

V

Consolidate Supply submits that Order No. 428, as written, requires clarification and modification with respect to the following:

First Matter for Clarification

At page 10 of Order No. 428, the Commission states:

> "Producers who have received small producer certificates prior to the issuance of this order, or who have applied and qualify but have not yet received such a certificate, will not be required to file new applications seeking exemption, unless otherwise directed."

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The Order promulgates new Subsections 157.40(e) and (f) as part of the Regulations, replacing Subsections 157.40(e) and (f) as promulgated October 2, 1970, by Order No. 411, which granted automatic certification to many small producers in the Appalachian and Illinois Basin Areas.

This replacement, without any notice, acknowledgment or explanation, of Subsections 157.40(e) and (f) would appear to eliminate the blanket certificate authorizations granted to small Appalachian and Illinois Basin producers, thereby requiring such producers to apply for blanket certificates under new Subsection 157.40(b) prior to May 2, 1971. If this is the case, it should be clearly stated.

Second Matter for Clarification

At page 7 of the Commission's Order No. 428, it is stated that "small producers shall be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein", but Section 157.39 of the Commission's Regulations makes the only producer abandonment regulations, that is, Section 157.30, inapplicable to small producers. Section 157.39 of the Regulations is, thus, contrary to the Commission's intent stated in Order No. 428.

In any event, Consolidated would still urge the Commission to adopt the view that the written consent of the pipeline purchaser should be the only prerequisite to the abandonment of a small-producer sale, and that formal applications should be required only where there is a dispute. In a great many cases, the well has been depleted, and there is nothing for the Commission to decide upon the filing of a small producer abandonment application.

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Third Matter for Clarification

Some small producers have been receiving increased minimum prices in excess of contract prices since October 2, 1970, without the necessity of filing for such increased prices, by virtue of Subsections 154.107(d) and 154.108(d) of the Regulations promulgated by Order No. 411. Such producers' prices

will revert to the lower contract prices under the new Subsection 157.40(c) if they apply for blanket certificates under the new Subsection 157.40(b), unless the small producers avail themselves of the permission granted in footnote 5 of page 9 of Order No. 428, but not reflected in the new Regulations, to file for the increased rates which were decreed in Order No. 411, to be effective without the necessity for any rate filing.

The question which suggests itself is whether many small producers can trace through this maze of contradictions to find the key, newly-required filing permission granted in a footnote to an Order which is not carried through to the Regulations.

WHEREFORE, in consideration of the above, Consolidated Supply respectfully prays that the Commission:

(1) Grant rehearing herein, reconsider its Order No. 428, as amended and supplemented by Order No. 428-A, and, upon such reconsideration, modify the aforesaid Orders to adopt fully the suggestions made originally in Consolidated Supply's Comments and Recommendations filed September 15, 1970, and renewed herein in the instant Application, or, in the alternative,

(2) Set this proceding for oral argument before the Commission, and,

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(3) Grant such other and further relief as may be appropriate in the premises.

Respectfully submitted,

CONSOLIDATED GAS SUPPLY CORPORATION

By /s/ NORMAN A. FLANINGAM

NORMAN A .FLANINGAM
Its Attorney

Filed: April 19, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers) From Regulation)	Docket No. R-393

PETITION FOR REHEARING AND FOR STAY OF PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

The Public Service Commission of the State of New York (New York), herewith files its petition for rehearing of the Commission's Order No. 428 issued on March 18, 1971. For the reasons set forth below, New York believes the Commission's Order must be set aside and the proceeding terminated. In addition, in view of the nature of the small producer problem involved herein, it is essential that the Commission take prompt action to stay the effect of its order of March 18, 1971 to ensure that it will not become effective until at least thirty days after the Commission action on rehearing.

1. The Commission's decision in Order No. 428 to relieve small producers of all obligations under Sections 4, 5 and 7 of the Natural Gas Act is without legal justification. The special provisions for small producers approved by the Supreme Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 786-7, were directly tied to the just and

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reasonable area rates for all producers established therein, and the small producers themselves were held responsible for any

deviations therefrom.[1] Under such circumstances the Supreme Court held that "the exemptions created by the Commission for [the small producers] are fully consistent with the terms and purposes of its statutory responsibility." Here, however, the Commission's scheme ties the propriety of the rate received by small producers to the unregulated field prices for interstate or intrastate sales, (but see *City of Detroit v. FPC*, 230 F.2d 810 (CADA, 1955) *cert denied*, 352 U.S. 829), and the small producers are even relieved of the obligation for complying with such standard. This is not a proper classification of small producers for separate regulation *within* the Natural Gas Act pursuant to the provisions of Section 16 of the Act, but *pro tanto* deregulation for which there is no statutory authority.

2. The Commission has not found, and on the basis of the filings in this proceeding or any other evidence or information of which it could take official notice could not find that the just and reasonable

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rates for the not inconsequential percentage of sales by small producers in interstate commerce[2] are either the "highest contract prices for sales by large producers" or the "prevailing market price for intrastate sales in the same production area." Just such a test has been declared to be improper even for fixing permanent certificate prices *pending* determination of just and

[1]The one permitted deviation from the area rate—the inapplicability of the quality adjustment provisions to small producers—was upheld by the Commission and the Court as having a *de minimus* effect.

[2]The 10.52% figure for small producer sales given in the body of the Commission's order underestimates the total percentage of sales which would be effectively deregulated. As the footnotes indicate, the figure does not include the substantial amount of gas originally sold to large producers and resold to pipelines.

reasonable rates. See, e.g., *Public Service Commission of the State of New York* v. *FPC*, 361 U.S. 195 (1959), summarily reversing 269 F.2d 865 (C.A. 3); *Public Service Commission of the State of New York* v. *FPC*, 287 F.2d (CADC, 1960), *cert. denied*, 265 U.S. 880, 882. Commissioner Carver's recent statements as to why producer deregulation is peculiarly inappropriate in the present period of gas shortage is just as applicable to the substantial amount of gas sold by the small producers as to large producer sales. And, let there be no misunderstanding; under the Commission's test the limitations on the prices for these sales which the Commission purports to be indirectly imposing through its regulation of the purchasers, is almost entirely form rather than substance.[3]

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3. In any event, regulation of the purchaser's rates is not an adequate substitute for regulation of sales subject to the Commission jurisdiction. See *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 681-683; compare *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, affirming 29 FPC 256. ("Control limited to approving the costs of the gas to the purchasing pipeline is, of course, not an effective way to regulate producer prices because in the large a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities.")

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[3]The retention of Section 7(b) abandonment jurisdiction is useful, but not relevant to the price problem. The limitation on the use of indefinite escalation clauses is of minimal significance. And the elimination from the exemption of sales by small producers where they acquired developed reserves in place from large producers, while an improvement on the original proposal still permits much too much trafficking in leases to avoid regulation, particularly since there is no definition of "developed reserves."

4. Even if there was some legal and factual basis for abandoning all effective rate regulation under the National Gas Act for future sales of natural gas by small producers, there could be none for the Commission's actions in applying its *de facto* exemption scheme to flowing gas. Specifically there has been no showing that small producers desiring to remain in the gas production business will not have, or be able to secure, adequate funds to conduct production operations pursuant to appropriate just and reasonable area rates, to say nothing of a higher, unregulated price for their new gas sales. At the same time it is evident that many of the small producers will merely pocket the extra compensation received for such flowing gas sales; many of the existing small producer sales freed from effective regulation by this order are made by entities which are no longer

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in the business and have no intention of re-entering it regardless of the Commission's action herein.

5. The provisions of Section 157.40(d) of the rule relating to the duration of the exemption are well calculated to breed avoidance of the proposed 10 million Mcf per year limitation.[4] The small producer keeps his exemption until the Commission "on its own motion or on application" issues an order terminating it, and all sales made prior to termination, including those which brought its sales above the cutoff limit, and those made subsequently, are blanketed into the exemption. Since there is no requirement that the producer file an application to terminate the status from which he benefits, he

[4]The rule contains no factual predicate for the Commission's unexplained action in choosing 10 million mcf per year as the dividing line between small and large producers. The fact that this figure has been utilized in other proceedings which did not involve *de facto* deregulation of small producer sales does not, of course, necessarily make its use appropriate here.

certainly will not do so. As a consequence, we have a system where the Commission will receive a mass of small producer reports on April 15th of each year from which it may be in a position subsequently to institute termination proceedings. It is evident that the slippage will be severe.[5]

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6. It seems clear that, as a minimum, the Commission should provide for an automatic termination of the exemption as of the time the cutoff figure is reached, with any formal Commission termination order operating retrospectively thereto. Also, it would seem that the annual small producer report should constitute an application for termination where it indicates the limit has been reached.

7. The Commission is rightly concerned about the effect of its rule upon plant sales by large producers. For one thing, the rule is bound to discourage future percentage sales, except by small producers otherwise in jeopardy of losing their exemption. This is unfortunate, since the percentage sale device seems a particularly appropriate one from the standpoint of both consumer protection and the best interests of the plant operator. (It also is a device which frees the small producer from all administrative burdens.) If, as a result of the Commission's unfortunate action, plant costs may be raised to a level which would justify an adjustment from the area rate for

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[5] Theoretically, the Commission staff will be in a position to institute termination proceedings at an earlier date as a result of its perusal of the mass of small producer contracts which pipelines and large producers are required to file under subsection (g) of the rule. In practice, we suggest that this filing requirement, except for its possible cosmetic effect, will merely serve to impose an unnecessary burden upon the purchasers. However, the requirement points up the fact that the non-regulatory system established by the Commission's rule, if it were to be enforced by the Commission's staff, would be at least as burdensome as the one it is intended to replace.

such producers, some form of procedure for seeking relief will necessarily have to be provided. But there is no justification whatsoever for the procedure incorporated into subsection (f) of the new rule. As examination of the discussion of plant sales in the Commission's Permian and Southern Louisiana area rate cases will show, the proper pricing of such sales is a most complex and controversial subject. Assuming that

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some of the seller s purchased gas costs are increased by the Commission's action in this docket, it by no means follows that any increase in the plant sale rate will be justified as a result. And certainly the test of whether any increase is justified cannot properly be whether "the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area." Since the Commission's order does not explain what is meant by the term "prevailing price differential in the area" it is not possible to know the exact scope of the standard which seems to be based on the erroneous concept that there is a one-to-one relationship between a small producer's sale to the plant operator and the latter's resale to a pipeline. In any event, it is clear that the ability to meet any such standard can justify acceptance of a rate increase filing without refund obligation.

8. In our opinion the most which is appropriate by way of relief to plant operators from the effects of the Commission's rule would be to provide an exemption to any moratorium on rate increase filings above the just and reasonable area rate where a large producer plant operates can show that its purchased gas costs have increased by more than 10% as a result of the Commission's rule. Any such filings which the Commission might permit would be suspended and subsequently allowed to become effective only subject to refund. And increases in plant operator rates above the just and reasonable area rate would be justifiable only where giving

consideration to all of the various components going into the establishment of such rates, it can be shown that the area rate is no longer appropriate.

9. Commission Order No. 428 by its terms is effective 45 days from its issuance, which shall undoubtedly be before it acts on this and other petitions for rehearing. We need not belabor the point as to the difficulties of unscrambling this particular egg, should the Commission permit the rule to become effective and then on rehearing rescind or substantially modify it. The same situation would apply after any Commission order on rehearing with respect to possible court appeals therefrom. We therefore believe the Commission must promptly announce that the effectiveness of its order will be stayed until at least 30 days after its decision on rehearing.

Accordingly, New York requests the Commission to grant rehearing and, upon its further consideration of the matter, set aside Order No. 428 and terminate rulemaking Docket R-393. The Commission should also immediately take action to toll the effective date of the order until at least 30 days after its opinion on rehearing.

Respectfully submitted,

Public Service Commission of the State of New York

/s/ Richard A. Solomon

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers) Docket R-393
From Regulation)

APPLICATION BY PHILLIPS PETROLEUM COMPANY
FOR A REHEARING OF ORDER NO. 428

COMES NOW Phillips Petroleum Company (Phillips) pursuant to Section 19 of the Natural Gas Act and Section 1.34 of the Federal Power Commission (Commission) Rules of Practice and Procedure and Petitions for Rehearing and Reconsideration of the Commission's Order No. 428 "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements", issued March 18, 1971.

I.

Under Docket No. R-393 "Exemption of Small Producers from Regulation" the Commission on July 23, 1970, issued Notice of Proposed Rulemaking. Phillips was one of the parties that submitted views, comments and suggestions to the Commission within the time allotted by said Notice for such comments, views and suggestions, and Phillips participated in the conference held in this case on December 8, 1970.

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Order No. 428 permits a producer whose total jurisdictional sales of natural gas are not in excess of 10,000,000 Mcf per year ("small producer") to secure a blanket certificate covering all existing and all future jurisdictional sales and to retain same until its total annual jurisdictional sales do exceed 10,000,000

Mcf. During the period such blanket certificate is in effect said small producer is authorized to make sales of gas pursuant to existing and future contracts at the prices provided by such contracts without refund obligation and without the necessity of filing for or receiving authorization therefor by the Commission.

II.

Order No. 428 is unlawful because:

1. Order No. 428 is at substantial variance in terms and substance with the Notice of Proposed Rulemaking and therefore violates the provisions of Title 5 USC 553.

2. The Commission has no statutory authority to exempt totally a class of producers from operation of the Natural Gas Act.

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3. Order No. 428 is patently discriminatory against Phillips in particular and other large producers in general in violation of Section 4(b) of the Natural Gas Act.

III.

The Proposed Rulemaking of July 23, 1970, was titled "Exemption of Small Producers from Regulation" and the justification and rationale set forth in such Proposed Rulemaking were directed toward this end. Conversely, Order No. 428 at page 4 of the body thereof disavows any deregulation of sales by small producers.

Perhaps sensing in part the futility of attempting to exempt totally a segment of the producing industry from regulation under the Act, the Commission seeks to forestall this by

shifting the burden of regulation from the small producers to the pipelines. Such indirect regulation, which is arguably beyond the scope of the Act, is certainly and without question beyond the scope of the Notice of Proposed Rulemaking of July 23, 1970. At page 4 of Order No. 428 it is stated that the Commission "will continue to regulate such sales, but will do so at the pipeline level by reviewing

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the purchase gas costs of each pipeline with respect to small producer sales." The Order thus introduces a new scheme and concept of indirect regulation which is outside the terms and substance contained in the Notice of Proposed Rulemaking thereby depriving Phillips of the Notice thereof and opportunity to comment thereon in violation of Section 553 of the Administrative Procedures Act.

Order 428 varies further in terms and substance from the Notice of Proposed Rulemaking in that said Notice was totally silent with respect to the inclusion of the royalty interest within the proposed exemption, whereas, at page 6 of Order 428 the Commission states that "if a royalty interest relates to a small producer sale, such interest shall be exempt . . .". As stated in the comments of Mobil Oil Corporation filed in response to the Notice of Proposed Rulemaking in making this very point, "the exemption of sales by royalty owners cannot logically be deemed 'minimal' in its impact upon producers . . .".

The Commission purports to find authority for the action undertaken by Order No. 428 in the language

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of Justice Clark in *FPC* v. *Hunt,* 376 US 515 (1964) and the recognition in the *Permian Basin Area Rate Cases,* 390 US 747 (1968) of the power of the Commission under Section 16 of the Natural Gas Act to "classify persons and matters within its

jurisdiction and prescribe different requirements for different classes of persons or matters." There is nothing in Section 16 which would grant the Commission power to classify persons in such a manner as to remove them totally from the clear requirements of the Act, and while Section 16 allows the Commission to classify for purposes of its rules and regulations, by no reading can it be construed to grant to the Commission the power to exempt any person from the mandatory language of Sections 4 and 7 of the Act. Section 4(a) states in part that "*all* rates and charges . . . by *any* natural gas company . . . shall be just and reasonable" and Section 4(c) states that ". . . *every* natural gas company shall file . . . *all* rates and charges for any . . . sale subject to the jurisdiction of the Commission . . .". Section 7(c) of the Act provides that "*no* natural-gas company . . . shall engage in the . . . sale of natural gas, subject

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to the jurisdiction of the Commission . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations . . .". The Commission itself in Order No. 174-b, 13 FPC 1576, 1577 (1954) in response to the urging that the regulations be amended to relieve small producers from the requirements of the statutes stated "the Act does not provide for exemptions from its requirements . . .". This, it is submitted, is clear recognition by the Commission itself that the authority to classify does not in and of itself include the power to exempt.

The Commission has sought for years to come to grips with the task of regulating independent producers. What is there for it to regulate? Certainly, it is not going to regulate the spacing or depth of wells nor such. It is to regulate the price and service by such producers. With one fell swoop the Commission deregulates a segment of the industry and throws to the winds the sacrosanct concept of just and reasonable rates by such segment. Phillips submits that any

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standard by which the price at which it sells its gas is held to a level which the Commission deems to be "just and reasonable" for Phillips while at the same time gas perhaps from even the same well is free to be priced in accord with the realities of the market is no standard at all, but is an unlawful, arbitrary and capricious classification.

In its initial comments Phillips warned of the situation which could be created by the proposed exemption and the resultant above-ceiling prices received by small producers in light of some recent court decisions. The Supreme Court of Texas in the case of *Texas Oil and Gas Corporation* v. *Vela*, 429 SW 2d 866 (1968) stated that the royalty payments to be made on the basis of "market price" under the terms of the lease were not controlled by the price received under the contract by which the gas was sold, but, rather, that "market price" was to be determined by sales of gas comparable in time, quality and availability to marketing outlets in addition to the particular contract. Under the facts in the *Vela* case the working interest owners selling gas under 1935 contracts for

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2.3¢ per Mcf were required to pay royalty on the basis of 13¢ per Mcf which was determined to be the "market price" prevailing in the field. The Commission's Order No. 562, 42 FPC 164 (1969) holding that royalty provisions of oil and gas leases constitute sales by the royalty owners for resale in interstate commerce and are thereby subject to the Commission's jurisdiction mollified to some extent the effect or application of the *Vela* case in that the Commission provided that the payments of royalties should be made as provided in the lease except that same should not be calculated on a value higher than the just and reasonable rates fixed by the Commission. Those producers now exempted by Order 428 from regulation who might have a

low price contract such as existed in the *Vela* case now find themselves with the ceiling having been removed and "market price" royalty payments conceivably being due upon an amount in excess of the area ceiling. Furthermore, this facet of Order 428's operation will operate to discriminate against large producers in that knowledgeable royalty owners quite likely will refuse to

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grant oil and gas leases to large producers preferring to reap the advantages of unrestricted sales by small producers.

In states such as Oklahoma where severance taxes are collected on the basis of "value" of gas production, the exemption granted by Order No. 428 will very likely increase the tax burden of both the exempted producers and unlawfully discriminate against the unexempted producers. Gas evaluated on the basis of the highest price being paid in the field or area in which it is produced will automatically be assigned a value commensurate with the higher prices being collected by the exempted small producers in that field or area rather than the regulated ceiling prices applicable to the nonexempted large producers in the same field or area.

Phillips pointed out in its comments filed in response to the Notice of Proposed Rulemaking that the rule as proposed seemed designed to drive Phillips from the business of extracting natural gas liquids from purchased gas. Order No. 428 confirms this discriminatory design, and it cannot be masked by the

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exclusion of percentage sales contracts from its operation nor by the provisions of ordering paragraph (A) 1 (f). Certainly no rational small producer is going to make a nonexempted sale to Phillips or other producer-plant operator at a percentage of the

ceiling price when he can sell his gas to an interstate pipeline at prices well above the ceiling plus liquid values. This is particularly true when the volume covered by such percentage sale, if made, would be included in the annual computation to determine whether such small producer has exceeded 10,000,000 Mcf and thereby lost his exemption.

Order No. 428 is patently discriminatory in that it gives to the pipeline purchasers a distinct advantage over large producers in the competition for the purchase of gas from small producers. The ordering provisions of the Order are silent with respect to the Commission's acceptance and/or suspension of tracking increases filed by pipeline purchasers to reflect increased prices paid to small producers under new or existing purchase contracts. In the body of its Order, however, the Commission states that ". . . the pipeline's

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rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." In comparison, ordering paragraph (A) 1 (f) provides that "a large producer may file for the *price specified in its related contract* for the resale of any natural gas sold to it by a small producer pursuant to the exemption authorized hereunder. Any such rate filing shall be accepted *if the price differential between the purchase and resale price does not exceed the prevailing price differential in the area,* and if the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area" (emphasis added). A pipeline purchaser may, therefore, increase its resale rates without contractual restriction or any limitation based

upon the prevailing price differential between the purchase and resale prices existing in the

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area. On the other hand, a large producer may not file for or collect a resale rate that is higher than that provided in its resale contract. Further, even if such resale is permitted by contract, the filing for such rate will be accepted only if the differential between such rate and the purchase price paid to the small producer does not exceed the prevailing price differential in the area. Because of the price limitations in its present resale contracts, Phillips will not be able to compete with pipelines for the purchase of small producer gas to supply its systems and plants and resell such gas under existing contracts. The only remedy available to Phillips will be to resell such gas in intrastate commerce or to make a new jurisdictional contract with its purchaser covering each new incremental supply of gas purchased from small producers. Even with the latter alternative the large producer remains at a bargaining disadvantage compared to the pipeline because of the filing requirements applicable to the large producer. A pipeline may negotiate a purchase contract with a small prodicer at the going market price in the area and commence accepting

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deliveries under budget type arrangements immediately upon the completion of the necessary facilities to connect such gas into its system. In contrast Phillips may offer the producer identical contract terms, but before it can accept deliveries it will be required to (1) negotiate a new resale contract with its pipeline purchaser (who will be a reluctant buyer if it is competing for the purchase directly from the producer); (2) file such new contract with the Commission, together with a certificate application for authority to resell such gas; and

(3) await Commission action with respect to said certificate application.

The Commission is urged to eliminate this preferential treatment afforded pipeline purchasers on rehearing by removing the limitations imposed on large producers which do not permit them to compete effectively for small producer gas supplies at prices as high as those that pipelines are permitted to pay by permitting large producers to enter into purchase contracts with small producers and after commencement of delivery to an interstate pipeline advising the Commission of such purchase and resale thus permitting such large producers

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to purchase volumes of gas from small producers and commence deliveries immediately to pipelines pending certification proceedings. This procedure would be analogous to the budget type arrangement of the pipeline purchasers. Additionally, a large producer should be permitted to resell gas purchased from a small producer, before or after processing, at prices sufficient to maintain the same differential that has heretofore been established between purchase price and resale price of gas sold at a plant or in the general area.

IV.

Wherefore, for the above reasons, Phillips submits said Order No. 428 is unlawful, inequitable and unduly discriminatory against it and requests that the Commission grant rehearing and reconsideration of its Order No. 428.

Respectfully submitted,
PHILLIPS PETROLEUM COMPANY
Kenneth Heady
John L. Williford

By /s/ John L. Williford
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April 16, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers)
From Regulation) Docket No. R-393

AMENDMENT TO APPLICATION BY PHILLIPS PETROLEUM COMPANY FOR A REHEARING OF FPC ORDER NO. 428

Comes now Phillips Petroleum Company (Phillips), pursuant to Section 1.11 of the Commission's Rules of Practice and Procedure, and tenders this amendment to supplement its application for rehearing of FPC Order No. 428 which was filed with the Commission on April 19, 1971, in the captioned proceeding.

I.

In said application for rehearing, Phillips attempted to point out to the Commission the discriminatory nature of said Order No. 428 in that pipeline purchasers are granted preferential treatment to the detriment of large producer purchasers of gas from small producers. At the time of the preparation and filing of said application for rehearing, Phillips could only refer to the advantageous position of a pipeline company in competition with a large producer for the purchase of a small producer's gas supply and predict the result of such uneven competition. Phillips explained that, because of the limitations in its present resale contracts, it will be unable to compete with pipelines for the purchase of small producer gas to supply its systems and plants and resell such gas under existing jurisdictional sales contracts.

(448)

However, in the short period of time since the issuance of Order No. 428 and even before the effective date of May 2, 1971, provided by said Order,

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the pipeline's competitive advantage and the untenable position of the large producer is now evident and Phillips's prediction of its inability to compete with a pipeline for the purchase of small producer gas supplies is now a demonstrable fact.

By Farmout Agreement dated September 25, 1970, Phillips assigned to Apex Oil Company, predecessor in interest to Bonray Oil Company (Bonray), certain leases in the West Sharon Area, Woodward County, Oklahoma, for development. Said Agreement, as amended by Letter Agreement dated October 29, 1970, reserved to Phillips the right to meet any bona fide offer received by Bonray, as to price and volume, for the purchase of gas well gas produced from such assigned properties. Such reservation is limited to a period of sixty days after the receipt by Phillips of such bona fide offer from Bonray.

The farmed out acreage lies within the area committed under the Gas Purchase and Sales Agreement dated April 15, 1970 between Phillips and Panhandle Eastern Pipe Line Company covering the sale and purchase of gas from Phillips' Cimarron Plant in Woodward County, Oklahoma. Said Agreement is on file with the Commission as Phillips' FPC Gas Rate Schedule No. 478. The initial price provided by said Agreement is 21.0 cents per Mcf at 14.65 psia, plus Btu adjustment. However, by its letter-order dated November 27, 1970, the Commission rejected Phillips' Rate Schedule, Rate Change and Quality Statement, which was filed in compliance with Opinion No. 586, and held that the applicable area rate under said Rate Schedule No. 478 is 18.5¢ plus appropriate adjustments. Phillips' petition for reconsideration of said letter-order was

filed with the Commission on December 16, 1970, and is still pending Commission action. Therefore, any offer that Phillips may make to Bonray for the purchase of gas well gas developed

on such farmed out acreage and for connection into its existing Cimarron gathering system must be limited by its resale rate under said Rate Schedule No. 478 to 18.5¢ or, upon reconsideration and approval of Phillips' quality statement, 21.0¢ adjusted for Btu content.

However, by letter dated April 15, 1971, a copy of which is attached as Exhibit "A" hereto, Bonray notified Phillips of an offer made by Northern Natural Gas Company (Northern) on that date for the purchase of gas from Bonray's Snow No. 1 Well located in Section 9-20N-21W, Woodward County, and other lands covered by said Farmout Agreement. The pertinent parts of Northern's offer are for the purchase of 2,000 Mcf per day at an initial price of 25.0¢ per Mcf, adjusted for Btu content above or below 1,000 with a 1.0¢ per Mcf escalation on July 1, 1972 and each five years thereafter.

Thus, although Phillips reserved the right in said Farmout Agreement to meet any bona fide offer for the purchase of such gas (and certainly expected to be in a position to do so), the Commission's Order No. 428 and its letter-order dated November 27, 1970, have destroyed Phillips' ability to compete for such gas for connection into its Cimarron system. Under these Commission determinations, Phillips' resale rate for such gas is limited to 18.5¢ per Mcf, plus Btu adjustment. Obviously then, if Phillips is to meet the offer of Northern, it will of necessity be required to by-pass its Cimarron system and sell such gas to an intrastate market. As a practical matter, Phillips' Rate Schedule No. 478 will be rendered ineffective, if not cancelled, and no gas will be acquired for resale to Panhandle Eastern thereunder.

For the foregoing reasons, Phillips submits that said Order No. 428 is patently unfair and discriminatory against the interests of large producers, and

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if said Order No. 428 is enforced the competitive position of large producers with respect to purchases of small producer gas supplies will be severely crippled. The inevitable result will be the decline of gas supplies for existing plant gathering systems, the construction of new and duplicative systems by the pipeline companies, and the diversion of new gas supplies into the intrastate commerce.

A further result of said Order No. 428 is made obvious by the above. Large producers will be extremely reluctant to farm out properties for development by small producers. In the past farmouts to small production companies has been a common practice in the natural gas industry. Through such farmout arrangements a large producer could achieve rapid development of its properties, without the necessity of investing huge sums of its capital in drilling equipment and expense, with the assurance that it would be able to purchase any gas developed by the assignee at a competitive price. Order No. 428 not only eliminates such assurance, but makes it virtually impossible for the large producer to compete for the purchase of such gas to supply its present resale contract commitments.

Wherefore, Phillips repeats its urgent request that the Commission grant rehearing and reconsideration of said Order No. 428. Phillips further requests that, pending rehearing and reconsideration, the Commission issue an order staying the effectiveness of said Order No. 428.

Respectfully submitted,

PHILLIPS PETROLEUM COMPANY

By /s/ W. M. Williams
Staff Supervisor
Laws and Regulations Division
Gas and Gas Liquids Department

Dated April 29, 1971

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BONRAY OIL COMPANY
1361 First National Building
Oklahoma City, Oklahoma 73102 CE 6-4668

April 15, 1971

EXHIBIT A

Phillips Petroleum Company
100 Park Avenue Building
Oklahoma City, Oklahoma 73102

Attention: Mr. Fred Terry

Gentlemen:

Reference is made to Article XI of that certain Agreement dated September 25, 1970, between Phillips Petroleum Company and Apex Oil Company, later amended by Letter Agreement dated October 29, 1970. Under the terms of the Amendment of October 29, 1970, and accepted by Apex on December 14, 1970, Phillips has the right for a period of sixty days to meet a bona fide offer received by Apex (*succeeded by Bonray Oil Company*) as to price and volume for the purchase

of gas from the lands described in Exhibit "A" of the Agreement dated September 25.

You are hereby notified of the offer made by Northern Natural Gas Company on April 15, 1971, for the purchase of gas from our Snow No. 1 in Section 9-20N-21W and other lands described in your Farmout Agreement. The offer is as follows:

Price
25.0¢ per MCF initially with a 1.0¢ per MCF escalation each five-year period commencing July 1, 1972, with upward and downward BTU adjustments from 1000

Takes
2,000 MCF per day for the first two years and, thereafter, based on a 1/7.3 ratio

Prepayment
The Contract contains a provision for prepayment based on $20,000 for each one BCF of proven reserves with a recoupment rate of 30 per cent of the proceeds due Seller for gas purchased. In the event of premature abandonment or if the entire prepayment has not been recouped at the end of a five-year period, a cash settlement will be made to Northern for the unrecouped amount.

Take or Pay
Effective thirty days after the latter of Seller's approval and acceptance of FPC Certificate of Northern's approval of Seller's title.

Processing
Seller retains the right to have said gas processed through the Amoco plant.

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Tax Reimbursement

Northern will reimburse Seller 87½ per cent of new taxes after effective date of Contract.

The BTU adjustment will add approximately 2.5¢ per MCF and the volume of liquids to be processed through the Amoco plant is estimated to be an additional 1.0¢ per MCF.

Please let us hear from you at your earliest convenience as to your decision regarding your right to meet this offer for the purchase of this gas.

Very truly yours,

BONRAY OIL COMPANY

/s/ R. H. Hefner, Jr.
R. H. Hefner, Jr.
President

RHH/cw

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR 157.39]

Before Commissioners: John N. Nassikas, Chairman
Lawrence J. O'Connor, Jr.
John A. Carver, Jr.
Albert B. Brooke, Jr. and
Pinkney Walker

Exemption of Small Producers)
From Regulation) Docket No. R-393

ORDER NO. 428-B

ORDER MODIFYING ORDER NO. 428
AND DENYING APPLICATIONS FOR REHEARING

(Issued July 15, 1971)

The Commission in Order No. 428 issued March 18, 1971 (36 F.R. 5598, March 25, 1971) in the above-entitled proceeding established a blanket certificate procedure for small producers. Small producers certificated thereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract.

Applications for rehearing of Order No. 428 were filed by James M. Forgotson, Sr. (Forgotson) on March 31, 1971, Mobil Oil Corporation (Mobil) on April 14, 1971, Texaco, Inc. (Texaco) on April 15, 1971, Phillips Petroleum Company (Phillips) on April 19, 1971, Warren Petroleum Corporation (Warren) on

April 16, 1971, Independent Natural Gas Association of America (INGAA) on April 16, 1971, Kansas-Nebraska Natural Gas Company, Inc. (Kansas-Nebraska) on April 19, 1971, Consolidated Gas Supply Corporation (Consolidated) on April 19, 1971, El Paso Natural Gas Company (El Paso) on April 19, 1971, Tennessee Gas Pipeline Company, A Division of Tenneco, Inc. (Tennessee) on April 16, 1971, and the Public Service Commission of the State of New York (New York) on April 19, 1971. By order issued April 29, 1971, the Commission provided for

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joint consideration of these applications for rehearing.

Some of the large producers claim that Order No. 428 casts a burden on them with respect to purchases from small producers which goes beyond the scope of the proposal in the notice issued July 23, 1970 (35 F.R. 12220, July 30, 1970) in this proceeding and is therefore invalid under Section 4 of the Administrative Procedure Act (5 U.S.C. 553).

In the July 23 notice the Commission proposed to apply Section 157.40 of its Regulations, as revised therein, to sales made by a small producer to a large producer, but not to the resale of such gas by a large producer. Under that approach resales by large producers might have been limited to the rate ceiling and any moratorium prescribed by the Commission in each area, but the notice also specifically directed attention to the possibility of a problem in this regard and invited comments with respect thereto.

As a result of the arguments made by certain large producers in their comments that resales of gas purchased from small producers are entitled to the same treatment as small

producer sales, the Commission in Order No. 428 provided relief to the large producers by permitting them to file for contractually authorized rate increases with respect to such resales, regardless of the ceiling or moratorium which would otherwise be applicable thereto. This modification alleviated some of the problems for large producers inherent in the original proposal, while at the same time providing adequate protection for consumers against unreasonable rates by setting a limitation on the rate level which would be accepted without refund obligation. Our actions, we believe, are in full compliance with the Administrative Procedure Act.

Warren contends it will be faced with the problem of purchasing gas from small producers which must be resold

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under old contracts containing prices that are not competitive with existing market values.* The order, according to Warren, places a large producer at a disadvantage since a pipeline may negotiate any price at the risk only of such price being found unreasonably high. Warren suggests elimination of this problem by allowing the large producer to pass on the additional cost incurred in the purchase of gas from a small producer under a new contract and to maintain its sales margin, irrespective of any price limitation in its resale contract. We have authority to remove contract price limitations under the *Sierra* doctrine.[1]

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*Phillips makes a similar argument in its application for rehearing, and in an amendment to such application for rehearing filed untimely on May 3, 1971, Phillips refers to a specific situation where it is unable to compete with a pipeline purchaser for a small producer sale.

[1] *F.P.C.* v. *Sierra Pacific Power Co.,* 350 U.S. 348.

But, the *Sierra* situation is not presented here. There is, however, nothing to preclude a large producer from renegotiating its resale contract if the purchaser is willing to do so.

Phillips states that even if a large producer is able to negotiate a new resale contract, it is still at a bargaining disadvantage with a pipeline because a pipeline may commence deliveries under budget-type arrangements as soon as a contract is negotiated with a small producer, while a large producer must wait for Commission action on its certificate application to resell gas under a new contract. Phillips urges the Commission to permit large producers to commence deliveries immediately and thereafter to advise the Commission of the purchase from a small producer and the resale of such gas to a pipeline pending action on its certificate application.

We think it desirable to help large producers maintain their competitive position with pipeline purchasers with respect to purchases of gas under new small producer contracts. Large producers, however, should be required to file a certificate application before commencing the resale of gas under a new contract. Consequently, we shall authorize large producers to resell gas purchased from small producers at any time after they have filed a certificate application pending action thereon, but any amounts collected for such resales in excess of the rate authorized in the certificate case shall be subject to refund with interest.

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Mobile claims that Order No. 428 is not clear as to whether the small producer will have a refund obligation on deliveries subsequent to March 18, 1971, where its rate was in effect subject to refund prior to that date or where an above ceiling increase is filed subsequent to that date. The blanket certificate authorized in our order will become effective as of May 2, 1971, at the earliest. Any refund obligation for the period prior to the effective date of a small producer's blanket

certificate will be disposed of in the appropriate area proceeding. Consequently, in both of the situations referred to by Mobil, the small producer's rate will be subject to direct Commission regulation at least until May 2, 1971. However, on and after the effective date of its blanket certificate, the small producer is authorized to collect its contract rate for an existing sale without refund obligation, regardless of the rate on file for such sale prior to the effective date of its blanket certificate and without regard to whether such rate previously was being collected subject to refund.

Suggestions have been made to require small producers to inform their co-owners and purchasers of their status as a small producer. In Order No. 428 small producers were required to serve their purchasers with copies of their applications. Aside from this requirement, we believe large producers and pipeline purchasers are in a better position to acquire and maintain this information as they have been required to do in the past in the Permian, Southern Louisiana and the Hugoton-Anadarko areas. We shall provide some assistance in this regard by appending to this order a list of all small producers who have received small producer certificates or who have applications pending as of April 30, 1971.[2] From time to time we shall update this list.

Small producers who receive blanket certificate authorization are required under Section 157.40(c) to obtain abandonment authorization under Section 7(b) of the Natural Gas Act

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for any sale made pursuant to Section 157.40. This requirement applies to sales to either large producers or pipelines. It also applies upon the expiration of a new or existing sales contract

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2The list does not include small producers operating in the Appalachian and Illinois Basin areas.

which provides for termination after a given number of years as well as prior to the expiration of a contract. Nor does it make any difference whether the purchaser consents to the abandonment. Authorization is required in any event. Footnote 4 relating to abandonment authorization on page 7 of Order No. 428 (p. 5600 of Federal Register Document 71-4044 published at pages 5598-5602 in the issue dated March 25, 1971) is confusing on this latter point and inconsistent with the text on that same page. The words "the pipeline consents to abandonment or" should be deleted from line 4 of that footnote so as to clarify the matter. We shall also modify Section 157.39 of the Regulations (which now provides that Sections 157.23 through 157.30 do not apply to those independent producers who are subject to Section 157.40) to accord with the provisions of Order No. 428. More specifically, we shall make the abandonment provisions of Section 157.30 applicable to small producers covered by Section 157.40.

Consolidated claims there is some confusion as to whether those small producers in the Appalachian and Illinois Basin Areas who automatically received small producer certificates pursuant to Order No. 411 are required to apply for blanket certificates under the new provisions of Section 157.40. They are not so required. As we indicated in Order No. 428, p. 10, small producer certificates previously issued to small producers are deemed to cover as of May 2, 1971 all sales covered under the provisions of Order No. 428. However, any producer initiating service in the Appalachian and Illinois Basin Areas after May 2, 1971, the effective date of Order No. 428, and qualifying as a small producer would be required to file an application for a blanket certificate.

Consolidated also questions whether small producers in the Appalachian and Illinois Basin Areas who have been receiving the minimum rate, without the necessity of filing therefor, in accordance with Order No. 411, in lieu of a lower contract rate, are required as a result of footnote 5 on page 9 of Order No.

428 to make a filing for the minimum

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rate in that area. Those small producers who have been collecting the minimum rate in that area are not required to make any filing. The purpose of the footnote was not to require a filing where none was previously required, but to make it clear that a small producer would be entitled to the minimum rate authorized by the Commission in each area even though it had a blanket certificate.

New York objects to the provisions of Section 157.40(d) pursuant to which a small producer who exceeds the 10 million Mcf annual limitation retains his status as a small producer until the Commission takes action. New York claims the slippage will be severe. They argue that, as a minimum, the Commission should provide for an automatic termination of the blanket certificate as of the time the cutoff figure is reached. This particular provision is the same as that adopted by the Commission in Order No. 308 after the issuance of the *Permian* decision in Opinion No. 468. There have been no problems under this provision thus far. Indeed, there has been only one instance where a small producer certificate was terminated. We also think it better to determine the appropriate cutoff date when action is taken to terminate the blanket certificate. In our view the use of the automatic cutoff date suggested by New York might cause serious problems for a small producer. Moreover, we think the cutoff date should be the date (April 1) small producers are required each year to report the volume of jurisdictional sales made in the prior year.

Forgotson contends the Commission lacks jurisdiction to issue Order No. 428. This position is based on his contention that the Supreme Court's determination in the *Phillips* case[3]

[3] *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954).

that this Commission has jurisdiction over sales

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for resale in interstate commerce by independent producers, while constitutional then, is no longer constitutional.

Forgotson's position is unsound. The Supreme Court as recently as 1968 in the *Permian Basin Area Rate Cases*, 390 U.S. 747, by its affirmance of the just and reasonable rates determined by the Commission in Opinion Nos. 468 and 468-A reaffirmed by implication, at least, its jurisdictional holding in the *Phillips* case.

It has also been asserted that Order No. 428 is defective because the notice did not advise pipelines that their purchased gas costs relating to new small producer sales would be subject to review.[4] Implicit in this argument is the assumption that, in the absence of these provisions in our order, pipelines would be free to make purchases from small producers under new contracts at imprudent prices. With this assumption, we disagree. Ever since the passage of the Natural Gas Act in 1938, pipelines as regulated public utilities have been permitted to include in their cost of service only those operating expenses, including the cost of purchased gas, which are reasonable. While our order placed emphasis on that duty, it did not effectuate any basic change in the pipelines' obligations in this regard. These obligations would exist even if nothing had been said in the order.

[4]The term "new small producer sale" includes, *inter alia*, gas sold by a small producer pursuant to a contract dated on or after March 18, 1971 which replaces an expired contract or pursuant to a contract amendment dated on or after March 18, 1971, modifying the terms of a contract dated prior to that date.

Similar objections to the Commission's standard for limiting a pipeline's reduction and refund obligation under a tracking increase are also without merit. The Commission in the July 23 notice proposed to allow pipeline purchasers to file tracking increases of rate increases resulting from the issuance of blanket certificates, but the collection of these tracking increases was to be subject to reduction and refund. In response to Consolidated's claim that the collection should not be so conditioned, the Commission in Order No. 428 modified

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the original proposal so as to limit the reduction and refund obligation of tracking increases to those which reflect small producer prices for new sales above the standard set forth therein.[5] The standard also provides pipelines with a more concrete guide for their future actions than would exist in the absence thereof. Simply put, the Commission wanted the pipelines to know in advance the boundaries within which they could freely contract with small producers.

Both INGAA and Tennessee object to the provision which limits tracking increase filings to those situations where small producer rate increases, or such increases together with other increases authorized for tracking, affect a pipeline's cost of purchased gas by one mill or more. INGAA urges that a minimum dollar amount be fixed for each company, or, alternatively that the adjustment amount be reduced to one-tenth mill where a pipeline designs its rates to that tolerance. While Tennessee makes no specific recommendation, it does claim that the

[5] There is no reduction or refund obligation with respect to increased purchased gas costs relating to rate increases authorized in existing small producer contracts.

present limitation is unreasonable for large pipelines. To illustrate, it states that under the present limitation it will be required to absorb all small producer increases until it experiences an overall annual increase of approximately $1,200,000 in its purchased gas costs. In view of its many suppliers, its frequent changes in rates and changes in purchase patterns, the limitation imposed is of minor significance. In addition, any reduction in the one mill limitation would substantially increase the number of tracking filings made by a pipeline during the course of a year to the detriment of the pipeline's customers. Consequently we shall retain the one mill limitation.

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Tennessee also inquires as to a pipeline's obligation in a situation where the operator of a producing property is a small producer who has a blanket certificate, but one of the non–signatory working interest is a large producer with an interest above 12½%. The large producer in such circumstances is required to obtain certificate authorization under Section 154.91 of the Regulations and to file the small producer's contract as its own as well as its operating agreement with the small producer. If the large producer does not obtain certificate authorization, he is not authorized to make any jurisdictional sales.

In Order No. 428 we indicated that the blanket certificate of a small producer would apply to a sale by a non-signatory small producer under a large producer's rate schedule. Tennessee asserts, however, that if a pipeline pays on the basis of the large producer's billing, it should not later be subjected to claims that the non-signatory small producer who has been selling under the large producer's rate schedule is entitled to a higher rate. For this type of sale a small producer will not be permitted to collect a higher rate than the rate in effect under the large producer's rate schedule for any period prior to the

date if notifies the large producer and the pipeline purchaser of its right to make the sale under its blanket certificate and the rate applicable thereto. However, a small producer who has filed for a small producer or blanket certificate prior to the issuance of this order shall have 30 days from the date of issuance of this order within which to make the notification required herein, and if it does so, such notification shall be effective as of the effective date of its blanket certificate.

Tennessee contends that the Commission's action of providing that the blanket certificate would be effective as of May 2, 1971, if a small producer had filed an application prior to the issuance of Order No. 428 or if it files one on or before May 2, 1971, regardless of the date of Commission action, is illegal because it would result in retroactive increases for small producers. Tennessee also claims the procedure is unfair because there is no way a pipeline can track retroactively the effect of this obligation.

The purpose of our action was to assure the small producer that its effective date for exemption would not depend on the happenstance of the date of issuance of a blanket certificate. Nor is there any retroactivity involved since the filing must be made on or before the effective date. The fact that Commission action will not be taken until after the date of filing does not make the action taken illegal.

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Such action is similar to the action taken by the Commission on an increased rate filing when it permits such filing to become effective as of the date of filing. Furthermore, there is nothing in Order No. 428 to preclude a pipeline in these circumstances from tracking an increase of this nature.

El Paso has suggested an alternative procedure to the one adopted by us pursuant to which the Commission would take

action within 60 days of the submittal of a new small producer contract by a pipeline. Under this approach the Commission would approve or disapprove the rate proposed, or, alternatively, indicate the proper rate level. During the 60 day review period the small producer would have the right to initiate deliveries without refund obligation and would be free after Commission action to terminate deliveries if it so desired.

The proposal does not go far enough. We want to facilitate the entry of the small producer into the interstate market and to assure the small producer that when he enters into a new contract, the provisions of that contract will not be subject to change. This can best be accomplished within the framework of the procedure we have adopted in Order No. 428.

Nor do we adopt El Paso's request that the first blanket certificates authorized under Order No. 428 be effective as of the first day of a calendar month, in lieu of May 2, 1971, to avoid costly and burdensome procedures in segregating purchases. We are reluctant at this stage to move the effective date back to May 1 and it would be inequitable to the small producers to push it forward to June 1. Moreover, the problems alluded to by El Paso are the same as those which arise each month when a producer places a higher rate into effect, subject to refund.

New York in its application for rehearing sought a stay of Order No. 428 until 30 days after the Commission's action on rehearing based on the assumption that the Commission might rescind or substantially modify that order, but that it might not do so until after May 2, 1971, the effective date of the order. With minor modifications,

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Order No. 428 remains intact. There is thus no justification for granting a stay now.

A number of other matters have come to our attention which warrant some discussion here. Small producer certificates issued pursuant to Order No. 428 will be effective as of May 2, 1971 if an application therefor was filed on or before May 3, 1971,[6] and as of the date of filing if an application is filed subsequent to May 3, 1971. Following the filing of an application, temporary authorization is not necessary for a small producer to commence new jurisdictional sales or to collect the contract rate for existing or new sales as of May 2, 1971, or the date of filing the application, whichever is applicable. The blanket certificate, when issued, will provide all of the necessary authorization.

As provided in Order No. 428, those producers who received small producer certificates under the procedure in effect prior to the establishment of the new procedure in Order No. 428 are deemed as of May 2, 1971, without further order of the Commission, to have blanket certificate authorization under Section 157.40(c) as now constituted.

In accordance with Order No. 428, small producers under favored-nation or other indefinite pricing clauses may charge the applicable area just and reasonable ceiling. The vintage of the gas involved will determine whether a small producer is entitled to the new or old gas ceiling. Where no just and reasonable determination is available, a small producer may charge the applicable area guideline initial rate ceiling, regardless of the vintage involved.

Finally, the blanket certificate authorization is applicable to jurisdictional sales made by a small producer from gas reserves acquired prior to the issuance of Order No. 428 by the

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[6] Inasmuch as the filing deadline fell on May 2, a Sunday, it was extended to May 3 pursuant to Section 1.13 of the Commission's Rules of Practice and Procedure.

purchase of developed reserves in place from

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a large producer. The problem sought to be solved in Section 157.40(c) by the exclusion from blanket authorization of sales from certain gas reserves has no applicability to previously acquired reserves. However, for acquisitions of developed reserves in place made on or after the issuance of Order No. 428, a small producer must apply for separate certificate authorization for jurisdictional sales relating thereto regardless of whether the large producer who sold the reserves in place retained any rights or reversionary interest in the properties involved.

The Commission finds:

(1) The applications for rehearing set forth no further facts or principles of law which were not fully considered in Order No. 428 (36 F.R. 5598, March 25, 1971), or which, having now been considered, warrant any modification of that order, except as hereinafter provided.

(2) The correction of footnote 4 in Order No. 428 (36 F.R. 5598 at 5600, March 25, 1971) and the revision of Section 157.39 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.39) prescribed in ordering paragraphs (B) and (C), *infra,* constitute a clarification and interpretation of Order No. 428, an existing order in this proceeding which was adopted in compliance with the requirements of 5 U.S.C. 553 after notice and opportunity to submit written comments which were received and considered by the Commission. Accordingly, further compliance with the notice, public procedure and effective date requirements of 5 U.S.C. 553 is unnecessary.

(3) The correction of footnote 4 in Order No. 428 (36 F.R. 5598 at 5600, March 25, 1971) and the revision of Section

157.39 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.39) prescribed in ordering paragraphs (B) and (C), *infra*, are necessary and appropriate for carrying out the provisions of the Natural Gas Act.

(4) Since the addition of paragraph (h) to Section 157.40 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.40) prescribed in ordering paragraph (D), *infra*, is consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

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The Commission, acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7, 16, and 19, 52 Stat. 822, 823, 824, 825, 830 and 831; 56 Stat. 83, 84; 61 Stat. 459; 15 U.S.C. 717c, 717d, 717f, 717o, 717r, *orders*:

(A) The applications for rehearing filed with respect to Order No. 428 (36 F.R. 5598, March 25, 1971) and New York's request for a stay are denied.

(B) Federal Register Document 71-4044 published at pp. 5598-5602, Vol. 36, of the issue dated Thursday, March 25, 1971, is corrected by deleting the words "the pipeline consents to abandonment or" in lines 4-5 of footnote 4, which footnote appears on p. 5600 at the bottom of the left-hand column.

(C) Part 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising Section 157.39 to read:

§ 157.39 Applicability of §§ 157.23 through 157.30

Sections 157.23 through 157.30 shall be applicable to independent producers as defined in § 154.91 of this Chapter, but, with the exception of § 157.30,

shall not apply to those independent producers who are subject to §157.40.

(D) Part 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations is amended by adding paragraph (h) to Section 157.40, as follows:

§ 157.40 Exemption of small producers from certain filing requirements.

* * * * *

(h) *Resale authorization for large producer.*

A large producer who has filed on or after ________________, 1971, an application

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for a certificate of public convenience and necessity for the resale of natural gas purchased from a small producer authorized to sell such gas pursuant to the blanket certificate provisions in paragraph (c) above may resell such gas at any time after the filing of its certificate application pending final Commission action thereon. Any amounts collected by a large producer for resales made pursuant to this paragraph in excess of the rate finally determined to be required by the public convenience and necessity for such resales shall be subject to refund with interest at 7 percent per annum.

(E) This order shall be effective upon issuance.

(F) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary

SUPREME COURT OF THE UNITED STATES

No. 72-1490

FEDERAL POWER COMMISSION, PETITIONER

v.

TEXACO, INC. et al.

ORDER ALLOWING CERTIORARI—Filed October 9, 1973

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted. The case is consolidated with No. 72-1491 and a total of one hour is allotted for oral argument.

Mr. Justice Stewart took no part in the consideration or decision of this petition.

SUPREME COURT OF THE UNITED STATES

No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS, ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., PETITIONERS,

v.

TEXACO, INC., et al.

ORDER ALLOWING CERTIORARI—Filed October 9, 1973

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted. The case is consolidated with No. 72-1490 and a total of one hour is allotted for oral argument.

Mr. Justice Stewart took no part in the consideration or decision of this petition.